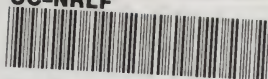


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Theodore Gilman

A GRADED BANKING SYSTEM. 16mo,
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FEDERAL CLEARING HOUSES. 16mo,
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HOUGHTON, MIFFLIN & CO.
BOSTON AND NEW YORK

FEDERAL CLEARING HOUSES

BY

THEODORE GILMAN

AUTHOR OF "A GRADED BANKING SYSTEM"



BOSTON AND NEW YORK
HOUGHTON, MIFFLIN AND COMPANY
The Riverside Press, Cambridge
1899

"In times of crises, reserves are essential, and it is of supreme importance that all the great banks of the country, at the moment a crisis comes, should be able to afford relief to their customers rather than feel at that moment bound to curtail the facilities they are giving. It is all very well for banks to give facilities to their customers in good times, but a customer looks to the bank for facilities when the pinch comes; and if when the pinch comes, the bank itself is obliged to draw in its resources, to call in money, it disturbs the whole of the mercantile arrangements, and the bank is not really assisting the country, but is thwarting the best interests of the banking and trading communities." "My object would be to establish a second reserve." — *Right Hon. G. J. Goschen, M. P., Chancellor of the Exchequer, in his speech at Leeds, Eng., January 28, 1891.* (See page 124.) SPRECKELS

"In the modern system of credit it is indispensably necessary that there should be some source to create and issue solid credit to sustain solvent houses in a monetary panic." — *Henry Dunning Macleod in "The Theory of Credit,"* page 848.

"If we could have had a hundred millions of such currency in 1893, it would have saved half or two thirds the ill effects of the panic." — *Charles Parsons of Saint Louis, Mo., in his letter to Hon. J. H. Walker, April 9th, 1898.* (See page 47.)

"That which you must say to the Governor and Regents of the Bank of France is that they should write, in letters of gold on the walls of their assembly room, these words: What is the end of the Bank of France? To discount the obligations of all the commercial houses of France at 4 per cent." — *Napoleon I. to Count Mollien, 15th May, 1810.*

"The objects (of the Constitution of the United States) were commerce, credit, and mutual confidence in matters of property; and these required, among other things, a uniform standard of value and medium of payments. One of the first powers given to Congress, therefore, is that of coining money and fixing the value of foreign coins; and one of the first restraints imposed on the States is the total prohibition to coin money." "The whole control, therefore, over the standard of value and medium of payments is vested in the general government." — *Daniel Webster, 1827.*

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PREFACE

THE object of this book is to present the reasons why the clearing houses of our country should be incorporated under a federal law.

A National Clearing House is the proper name for one organized under an act of Congress. The word "federal" is introductory, and has reference to the mode of formation rather than to the completed organization.

A clearing house is primarily a trustee for its bank members, into whose hands debtor banks pay their dues, and from whose hands creditor banks receive the amounts to which they are entitled. The clearing house has no power to use the money which thus comes into its hands for any other purpose than to divide it among and deliver it over to the creditor banks. Any other use of the money would be a breach of trust. Therefore the service rendered by a clearing house is that of a trustee. As banks come together daily at the clearing house to make their clearings, they find it convenient to use the slight organization of the clearing house for other purposes connected with banking inter-

ests. The clearing house adopts rules regulating collection charges and inspections. If it becomes necessary to issue clearing-house certificates it acts as trustee to hold the security therefor, and through its loan committee it passes on the sufficiency of the collateral offered.

All the services rendered by clearing houses are of a fiduciary character. They are vital to the welfare of banks and important to the entire nation. The functions and mode of organization of clearing houses, however, are in a rudimentary and sometimes inchoate state. They should be both developed and made uniform. This can be accomplished only by an act of Congress providing for their incorporation under a general law which would apply equally to all, and whose benefit would be open to all.

By this step, the operations of clearing houses would be brought under government supervision, and arbitrary action would be avoided. Above all a trustee would be created with whom the government could deal, enlarging or abridging its powers as might seem fit, and imposing duties, responsibilities and privileges on it which could not be safely conferred on popular, individual, and multiple banks.

The discussion contained in this book is in-

tended to show the advantages which would result both to banks and the business community from thus bringing clearing houses into our banking system and placing them under government supervision.

The reasons are based on the fundamental principles of the credit system, on business experience, on the evidence of history, and on the political requirements of our system of government.

The argument is intended to prove primarily that the credit system requires an adjunct which shall provide a currency for its support based upon a credit disconnected from and independent of the banks. If there were no such need of assistance, the discussion would be useless. If the assistance required by the credit system need not be independent of the banks, then the incorporation of clearing houses to render that service would not be required. These two points, the occasional need of assistance, and that such aid shall be of a higher grade of credit than that of the individual, local banks, are two of the starting points in this discussion, or rather two points to which we must continually recur.

Under the credit system commerce is transacted in the money declared to be legal tender by the government. That money is either metallic or the

paper notes of the government. No other money can properly be made a legal tender. The Constitution so declares it. The credit system allows the transaction of credit operations which are maintained at par by the legal tender money of the country. From four to six times as much business can thus be done as could be if there were no credit system. The idle capital in the form of cash is thus one quarter or one sixth of the amount it would be if legal tender were used in all money transactions.

The credit system is liable to derangement or interruption or collapse from various causes, such as wars, crop failures, over-trading, failures in business, or any events which shake the confidence of people in that which they had hitherto considered substantial, unassailable, and secure. Confidence must then be reassured and the commotion calmed before the credit system will resume its former regular mode of operation. Cash, or legal tender money, is the best assurance which the credit system can have, but when financial alarm is aroused, it is found that there is only one quarter or one sixth or one eighth or one sixteenth of the cash on hand needed to meet all demands. The rest has vanished.

There are two ways out of the dilemma thus

presented. One is obtaining money by forced liquidation, which produces distress and panic, and the other is providing the needed cash by means of some adjunct which is independent of the credit system and disconnected from the banks. This must rest upon such a solid basis that no question can be raised as to its goodness. The necessity for this assistance is proved by the frequent recurrence of monetary disturbances, by the beneficent effect of increased accommodations at such times, by the structure and laws of the credit system, and by the history of monetary panics.

This book is also intended to show how clearing houses are fitted to become the adjunct above described.

A former book on this subject by the present writer was entitled "A Graded Banking System." "Federal Clearing Houses," is, however, a title which has the advantage of being more specific. The two books together unfold the subject of currency and banking reform sufficiently to enable the reader to form an opinion of the merits of the proposition they contain, and to indicate to him points on which further investigation can be made.

Some of the following chapters have appeared in the "Bankers' Monthly," "Sound Money," the

New York "Tribune," "Evening Post," "Commercial Advertiser," "World," "Sun," "Financier," and other daily papers. Their original form has been but little altered, as the intention is to give the reader the line of argument as it has presented itself to the writer.

T. G.

NEW YORK, *December*, 1899.



FEDERAL CLEARING HOUSES

I

THE BANKING PROBLEM

THE American people have set before themselves the most difficult problem possible in government. It is based on the dictum that all men are born free and equal. It proceeds on the principle that all government should be by consent of the governed. It requires first an adhesion to a written constitution which gives a guarantee of a republican form of government, and permits all questions to be decided by a majority vote. A self-government of this kind requires, not a property qualification, but a qualification of intelligence and education. To educate a great nation, with the distinct purpose that it shall be a people able to understand the principles of government and to apply them wisely and intelligently by a majority vote, is the crowning glory of our times and of the American people.

To deny castes, special privileges, and monopolies is a necessary result of republican principles. To create courts where the humblest citizen shall

be on a par with the highest, and to enact general laws of which all may have the benefit, under which all may be equally protected, is the development of the principle laid down at the beginning of the history of our government.

There has been no more difficult subject for our government to deal with than that of banking; and now, over a hundred years after the formation of our nation, the question of the hour may fairly be stated thus: Can a system of banking be formed in accordance with republican principles which will be strong and sound enough to withstand all the shocks of panic, and as strong and sound as any of the systems formed in other countries by the grant of special privileges and monopolies?

One hundred and twenty years after our Declaration of Independence, republican principles are put to a new test. Our government has withstood the shock of foreign and domestic wars, has passed through trials which have threatened its existence, has established its courts of justice which command the respect of the world, has maintained peace at home and commanded it abroad, has met question after question which perplexed and distressed us, and has solved all of them in its own way in harmony with its institutions.

And now the banking system presents itself as a problem unsolved in all these one hundred and twenty years, and we are told that at last we have

reached a question which cannot be settled by the application of our national principles; but the solution is easy and ready if we will but recognize this failure, and, abandoning the principles which have thus far guided us, will give up our efforts and adopt the short and easy road of a special charter and a banking monopoly.

It must be acknowledged that all do not allow the necessity for any change in, or addition to, our banking system. Notwithstanding we have had three panics in four years, — in 1893, 1895, and 1896, — and many others in previous years, there are some who think our present means and appliances are sufficient, and that we can go on in the future as in the past. This, however, is not the general view; and there is a widespread demand for some change in our banking system which will give us financial stability and quiet, and prevent our constantly recurring panics.

Students of political economy who return from the universities of Europe tell us that the professors there teach their classes that financial stability cannot be attained under our banking system. Charles Gide, professor of political economy in the university of Montpellier, France, may be taken as an exponent of this view. In his work on Political Economy, he discusses the question of monopoly or liberty in banking (p. 309). He asks, Ought the legislator to reserve for one bank alone the right of issuing notes, or should the right be thrown open to all who care to use it?

This is the question of monopoly versus competition. He then takes the Bank of France as an example of monopoly, and the United States national banking system as an example of competition, and asks, Which are we to prefer of these two systems, — which offers most guarantees to the public, and which gives most stability to finances?

“It is on this point,” he says, “that we find an argument for monopoly. A bank holding an eminent position in a country, and rendered strong by its history and its traditions, will carry into the matter of issuing its notes all the prudence that is desirable, and this of itself is the only efficacious guarantee. The Bank of France note has proved its mettle, and in ninety years has never fallen below par. The Bank of France has allowed only one reproach to be brought against it, — that of excessive caution. To sum up,” he continues, “we must choose between these two systems, — either monopoly, with the most perfect freedom as regards the issue of notes; or competition, with severe regulations as to issues. In either case we must sacrifice some freedom, and in our [his] opinion there is less to suffer from the first system than there is from the second.”

This is a fair statement of the views of those who favor a governmental bank. Another example of monopoly in banking is afforded by the Imperial Bank of Germany, the operations of which are well described in “The Theory and History of Banking,” by Professor Charles F.

Dunbar, of Harvard College. Since its establishment twenty-five years ago, Germany has not been visited by a monetary disturbance which the Imperial Bank has not been able to control.

It must be acknowledged, then, that a banking monopoly will accomplish its object, and can be so ordered that financial stability and quiet will be maintained thereby.

In the United States we have abandoned the idea of special charters for banks. Banking with us is free to all, under a general law which creates separate, independent, and competitive banks. This result was reached in compliance with a popular demand, with the definite purpose of bringing banking in this country into accord with the Declaration of Independence. When the first general law was passed by New York in April, 1838, it was hailed in Congress as "a new declaration of independence." So it was. We have, then, here a test of republican institutions. Can we have financial stability, and immunity from panics, under a banking system which is founded on republican principles? If not, then let us make haste, and with confusion of face adopt monopoly in banking, and acknowledge that republicanism will do well in other ways, but, when it comes to banking, its principles must be abandoned.

But there is no need of making this acknowledgment: our republican banking system can be made as preëminent as is our judicial system. It

needs but to be completed. The same method by which we organize individual citizens into communities and states, and yet preserve their equality and independence, can be applied to organize individual banks into groups, clearing houses, and clearing-house districts. Our individual banks are the units in our financial system. If units are not combined into groups with mutual relations, there is no system. Says Ulysses, in "*Troilus and Cressida* : " —

"Take but degree [gradation, order, ascent] away, untune that string,
And, hark, what discord follows ! each thing meets
In mere oppugnaney."

The simple expedient which will introduce system into our banking methods is to give United States charters to our clearing houses. When once brought under governmental control as federal clearing houses, it will be safe to grant them such additional powers, not possessed by individual banks, as may be needed to constitute them sources for the issue of solid credit in times of financial alarm or of active business. This would make a banking system which can be compared with the successful governmental banks of Europe.

The four large banking systems of the world are those of France, Germany, England, and the United States. For years there has been hardly any discussion of banking methods in France and Germany with the purpose of introducing radical changes into their systems.

In England and the United States, changes in the banking systems are living political questions. The agitation in this country enters into all our election campaigns, and the currency question is at times the only dividing line which separates parties.

In England, beginning immediately after the Baring panic of 1890, the most prominent and absorbing question, in banking and business circles, has been the defect in their banking system, which leaves the country the prey to panic, and gives it, as the only protection, some form of suspension of the bank charter, or dependence on outside aid. That loans from the Bank of France should be the main reliance of the Bank of England is too humiliating for British pride to contemplate with equanimity.

The proposals made at the Leeds dinner, January 28, 1891, by Mr. Goschen, then Chancellor of the Exchequer, were a vain attempt to devise some means which would be a satisfactory substitute for suspension of the bank charter or appeal to outside aid. In his speech¹ Mr. Goschen said that he was "engaged, and hopefully engaged, with the assistance of the authorities of the Bank of England, in devising a scheme by which we may strengthen the permanent reserves of the country, by which we may give greater help in emergencies, and by which we may hope that some of those fearful catastrophes which have sometimes

¹ Mr. Goschen's speech is given on page 124.

threatened the commerce of this country [England] may be avoided. I am engaged on plans of that kind, and I trust I may be able to give effect to them." The remark suggests itself, that previous changes in the banking system of England were made by the government alone; and as the Bank of England is a private corporation, and a party interested on one side of the case, measures satisfactory to the public could hardly be expected as the result of Mr. Goschen's conferences.

In speaking of the cash reserves of the country apart from the question of gold, he said: "I must give utterance to a strong conviction which I hold that the banking reserves of the country are inadequate to its necessities, and are too small as compared with the gigantic liabilities which our large institutions have incurred." Having escaped a great catastrophe "by the skin of their teeth," the financial public of England must consider methods for protecting themselves in the future.

Mr. Goschen depicted as follows the dangers of a bank-note currency issued on the credit of the banks. "Paper," he said, "expels gold unless you take particular precautions to retain the gold, and for my part I am totally opposed to any measure which would simply end in the expulsion of gold from the circulation of the country. I would have a separate stock of gold realized to this country by a certain issue of paper money,

which was to be issued only when emergencies should arise." He proposed that this second reserve should take the place of a suspension of the charter. "An internal panic," he said, "might be saved by a further issue of notes, not as at present on credit, but against a reserve which has accumulated by such measures as I have endeavored to describe."

The underlying thought, the motive, of Mr. Goschen's speech is, that the credit system requires an adjunct for its support, which should be independent of and disconnected from the banks, and which cannot be used by the banks as a common resource in their ordinary every-day business.

The "London Times" explained the proposals as follows: "The government would forego the profit on the issue, and accumulate the gold under special and stringent conditions, to be utilized in case of a crisis such as would justify a suspension of the bank charter. As we understand Mr. Goschen, this would constitute the supplementary reserve he wishes to see established. All depends upon the absolute security of the new reserve against ordinary demands on the part of the holders of notes coming to be paid in sovereigns."

The proposal seems to have some of the characteristics of the French system, by which a reserve of gold is accumulated by the issue of notes, and thereafter held by the bank subject to use without

regard to the payment of the notes by which it was obtained. The difficulties would be great in the way of engrafting on the Bank of England this method of providing a reserve.

Mr. Goschen clearly states that an issue of notes to sustain the credit system must be based on something else besides the credit of the banks. He condemns the use of the printing-press, meaning thereby issues of bank-notes against assets in the hands of the banks. He does not object to the printing-press if the notes printed are secured by gold. Mr. Goschen, then, does not object to paper, but to the way the paper is secured. If secured by a special pledge of gold, he approves it; if it is issued on the credit of banks, he disapproves it. As the gold cannot properly be used twice as security for a fiduciary issue, the security of gold values in the form of banking assets, with safe margin, might not seem an unsuitable substitute for the gold itself. These banking assets are accumulated by the banks in the regular course of business, and no special effort is required, such as is proposed by Mr. Goschen, to accumulate gold.

His suggestions for a second central reserve, or for a fiduciary issue of currency, have not been formulated into a practical measure, which, for months after Mr. Goschen made the proposal, the public attentively waited for.

The London money market has another difficulty to contend with, which is paralleled in New

York. The growth of outside banks has made the influence of the Bank of England proportionately less than it was in former years. These banks, like the trust companies in New York, with their immense deposit obligations, hold real cash reserves which amount to but a small percentage of their liabilities, and their chief if not sole reliance is, in the one case, on the reserve of the Bank of England, and, in the other, on that of the banks associated in the New York Clearing House. Mr. Goschen mentioned one bank in London with forty-five million dollars of deposits, whose cash balance was about six per cent. As far as the obligations of these outside banks are on demand, — and they are mostly so, — they weaken and diminish the apparent and visible reserve in that proportion.

As long ago as 1856, the then Governor of the Bank of England, T. M. Weguelin, in a letter to Sir G. C. Lewis, then Chancellor of the Exchequer, commenting on the small reserve carried by London banks other than the Bank of England, wrote that this state of affairs constituted “a new and hitherto little considered danger to the credit of the country.” To impose upon these outside banks and trust companies, in New York and London, the duty of maintaining a cash reserve equal to that of the Bank of England and the Associated Banks of New York, would be unpopular in New York, and Mr. Goschen said he would not undertake to propose it in London.

Since 1891, the discussion as to the reserves of the banks of London has seldom flagged in interest, and every threatened war or other commotion has given it new life and interest. And now, seven years after Mr. Goschen made his Leeds proposals, and forty-three years after Mr. Weguelin wrote his letter to Mr. Lewis, the consideration of the best means of maintaining bank reserves "is the chief theme of discussion in banking circles" in England, or, as another English writer has said, "the weakness of our specie reserves is the most important point at the present moment" (July, 1899). Again, the Chancellor of the Exchequer, Sir Michael Hicks Beach, at a dinner given June 28, 1899, by the mayor of London, takes as the burden of his speech the necessity of reform as to banking reserves. He thought that "it was felt that the great and ever-increasing fabric of credit rested at present upon a very narrow cash basis." The London "Bankers' Magazine" for August, 1899, says that a committee of the Central Association of Bankers is still examining the question. "It would be a thousand pities," it adds, "if this well-directed effort at reform were to prove as ineffective as the attempt in the same direction made when Mr. Goschen was Chancellor of the Exchequer." This public acknowledgment on the part of two Chancellors of the Exchequer, and of the Central Association of British Bankers, and of prominent financial periodicals, of the pressing need of reform in

their system of banking reserves, should convince American bankers and legislators that they have little to learn from the English banking system as it exists at present. It would be wiser to wait until the proposed reforms have been threshed out, and embodied in an act of Parliament, before taking the English banking system as a model for imitation.

In France and Germany the case is different. They have systems which work in the main satisfactorily, and we have, therefore, England and the United States on one side, with their turmoil of banking discussions, and France and Germany on the other, comparatively free therefrom, as representatives of two different systems of banking. The chief point of distinction between the two systems is, that in France and Germany they have credit currencies for domestic use, while in England and America we have none, but rely upon our reserves of gold and legal tenders to meet occasional demands for currency.

The problem is so simple that it can be stated in a few sentences. The tendency with banks to employ their money "up to the hilt," to use Mr. Goschen's expression, — that is, up to the legal reserve limit, or the limit of the "apprehension minimum" — is inevitable. The desire to make as much money as possible for their banks is universal with directors. Therefore, when there is a demand in England and America for currency to move crops, for the holiday seasons, or for active business uses,

our banks must draw on their reserves of gold or legal tender to meet the demand; while in France and Germany the same kind of a demand would be met by bank-note currency, which is issued on the basis of business assets by a few banks of special grades above the popular banks. The effect of these two systems on business is, that in England and America the drains of gold come at frequent intervals, and every time a drain occurs it upsets business, and causes unexpected liquidations, great inconvenience, and loss; while in France and Germany the issues of bank asset currency go out and come in automatically, or as a matter of routine, with slight influence on business, and in France with hardly a perceptible change in the rates for money, year after year. To avoid this difficulty in our country, a credit currency is imperative.

The issue of a fiduciary currency based on the credit of the banks under English methods of banking is attended with such dangers that the two chancellors both recoil from proposing such a measure. But the "up to the hilt" tendency, and the monetary disturbances which result therefrom, must be accepted as inevitable. Mr. Goschen and Mr. Beach both seem to think there is no middle ground between a fiduciary issue made by banks holding in their own custody the banking assets on which it is based, and an issue of notes based pound for pound on gold. The latter kind of issue has none of the elements of a credit currency,

and would not be a protection to credit, except by the costly method of carrying a stock of idle capital in the shape of unused gold to meet temporary demands, which is the very waste and loss the credit system is designed to avoid. Mr. Goschen and Mr. Beach fear an issue which would expel gold, and yet, if they would consult English financial history, they would find instances where a third method has been employed with unvarying success. It is the issue of a credit currency based on banking assets held by a trustee, like the Parliamentary Commission of 1793, and pledged for the redemption of the currency. Such currency cannot cause a suspension of specie payments, because under these "particular precautions" it is based on gold values, and must be redeemed in gold or cancelled by mutual set-offs. The pledge of collateral puts a pressure on the banks to redeem their notes. All the fears of the two chancellors of a loss of gold are groundless when such a currency is considered. The London Clearing House or the Bank of England should be the trustee to hold the security collateral to the currency issued.

English banking will apparently continue in its present deadlock until their bankers and legislators see that a credit system cannot be conducted safely without some source or sources for the issue of solid credit in times of financial alarm. And they must further recognize that these sources must be independent of individual popular banks,

and therefore the credit issued must be secured by ample collaterals. As the English mind slowly gives up accepted ideas, even though recognized as defective, we must expect a long delay in the coming of any reform in their banking system.

As we turn to the United States, a more promising prospect opens up before us. We have the foundation of a logical formation of individual banks, incorporated under general laws, to build upon. Our general banking law provides a government inspection, and a prescribed percentage of lawful money reserve, which England has not, and which it seems impossible to attain by voluntary agreement. We have started right, and have laid a true foundation in accordance with the everlasting principles of the equal rights of man. We have had a good experience with state banking systems, and have found that they work to the entire satisfaction of the people of each separate State. We have a system of clearing houses already formed, which is waiting to be incorporated into the national system. All the material is ready, we have had our own experience to guide us, and we have the example of successful governmental banks in France and Germany. We can see the parallel between a governmental bank and a clearing house, the one monarchic the other republican, and both performing the same functions and occupying the same relation to popular banks. We have passed through the contest over special charters, and have decided in favor of

general laws ; and now we shall make no future progress or take another step in banking reform except by means of a general law, the benefits of which will be open to all the people without distinction. We have for our guide in the National Bank Act as perfect a general law as can be framed by Congress. While it may seem to some that the progress of this country to a solution of banking difficulties has been slow, when we consider the wisdom of the laws which have been enacted and the many questions we have settled and have left behind us, and which even England has before her, we can then see that this country is many years nearer the end of the long debate over financial questions than are many peoples who consider themselves in advance of us.

These general remarks lead us to the discussion of the details of the proposed measure and of principles and facts to substantiate the positions claimed, and of the various errors which are constantly met, and which it is necessary to answer and remove.

II

NOTE ON THE PROPOSED BILL

THE bane of financial discussions is that they are apt to be theoretical and not practical. It was therefore a wise rule of the Committee on Banking and Currency of the 54th and 55th Congresses that no suggestions for banking reform would be heard unless they were accompanied by a bill in which the proposed plan was presented in form ready for examination.

To meet this requirement the following bill was prepared, and to secure attention and discussion was introduced in the 54th Congress by Hon. E. H. Fairchild and in the 55th Congress by Hon. Richard Bartholdt.

It was prepared after a study of the banking laws of all the States and of Congress. It is framed chiefly on the plan of the National Bank Act, and borrows some of its provisions and phraseology from the laws of New York, Iowa, Indiana, and other States.

The National Bank Act grew out of the laws of the different States, and this bill is a development in the same line. The objects aimed at in the bill are to incorporate clearing houses under a federal law; to restrict their operations so that

they shall not conflict or compete with popular banks in any of their functions ; to give the benefit of membership to all commercial banks in good standing organized under state or national laws ; to give to one clearing house in each State the power to issue currency to its members at seventy-five per cent. of the value of banking assets pledged ; to require all members of clearing houses to accept this currency for all dues to them ; to make the borrowing bank the first guarantor of the notes advanced to it ; to make the banks of a State or district the second guarantor, and as such liable for any loss on loans made by the clearing house of which they are members ; and any further loss to be assessed pro rata on all other clearing houses organized under this act, as the third guarantors.

There would thus be forty-five or fifty clearing houses of issue throughout the United States, and the benefits therefrom would be distributed equally in accordance with banking capital throughout the Union. This would avoid centralization, or the congestion of funds in large cities. The local issue of currency is thus attained.

The liability to a contingent loss would make loan committees cautious, the danger from excessive issues of currency would be reduced to a minimum, and there would be a constant pressure on the banks to retire this currency and take up their collateral. Yet the relief to be obtained by issues of sound credit would always be available in case of need. These issues would go out from banks in place of

their reserves, which would be retained undiminished for use in settlement of foreign balances. Under our present system any call for money must be met by drafts on reserves; and as reserves diminish, the obligations of the banks must be diminished *pari passu*. This is the cause of spasms in the money market, or panics. By providing the banks another way of meeting sudden demands for currency, borrowers will be protected, and a great benefit conferred on all the people.

The essential feature of bank note issues under a general law is the deposit of approved collateral security in the hands of a trustee of acknowledged standing. By this bill, the clearing houses of issue are made such trustees. Their number being comparatively small, about fifty for 75,000,000 people, and each being representative of the banks in its district, they would become prominent and responsible bodies, whose acts could be reviewed by Congress, and whose responsibilities and functions would increase or diminish without disturbing legislation regarding the popular banks. The latent power of assistance possessed by clearing houses of issue would place our banks in an impregnable position, and panics like those of 1873 and 1893 could hardly recur if this system were in operation.

The essential feature of a general law is that all the people can have the benefits of its provisions. The National Bank Act is open to all who desire to engage in banking. An act incorporat-

ing clearing houses should also be open to all banks duly certified by state or national authority. It would then be an act, not only for the protection of commerce and trade, but for the pecuniary benefit of any who wish to avail of its provisions. All foundation for the prejudice against banks would thereby be entirely removed.

III

HEARING BEFORE THE COMMITTEE ON BANKING AND CURRENCY, HOUSE OF REPRESENTATIVES — BILL INCORPORATING CLEARING HOUSES

THE committee met at 10.30 A. M., Hon. Joseph H. Walker in the chair.

Present : Messrs. Walker, Johnson, Van Voorhis, McCleary, Fowler, Spalding, Hill, Southwick, Prince, Mitchell, Capron, Cox, and Ermentrout.

Theodore Gilman, a banker of New York City, appeared before the committee in advocacy and explanation of the bill H. R. 9279.

[Bill H. R. 9279, Fifty-fifth Congress, second session.]

In the House of Representatives, March 17, 1898.

Mr. Bartholdt (by request) introduced the following bill ; which was referred to the Committee on Banking and Currency and ordered to be printed.

A BILL to protect and support commercial credit, to equalize rates of interest, to provide for the incorporation of clearing houses, to regulate and define their operations, to provide a clearing-house currency, secured by pledge of commercial assets and the responsibility of the associated banks, and to provide for the circulation and redemption thereof.

Be it enacted by the Senate and House of

Representatives of the United States of America in Congress assembled, That associations, Articles of Association. to be known as clearing houses, for the settlement of money transactions by effecting clearances between banks, and for doing other business for and between banks not inconsistent with the provisions of this act, may be formed by any number of banks not less than five, duly incorporated, either under the National Currency Act or under the laws of any State or Territory, of which a majority shall be organized under the National Currency Act, in any city of not less than six thousand inhabitants, who shall enter into articles of association for the regulation of the business of the association and the conduct of its affairs, which said articles shall be approved by the stockholders of each bank uniting to form the association at a meeting called for the purpose and shall be signed by the officers of each bank by authority conferred upon them to do so by vote of the stockholders, and a copy of them forwarded to the comptroller of the currency, to be filed and preserved in his office.

SEC. 2. That the banks uniting to form such an association shall, by their proper officers, make an organization certificate, which shall Organization Certificate. specify —

First. The name assumed by such association, which name shall be “The Clearing House of (giving the name of the city where located and where its business of effecting clearances shall be carried on).”

Second. The names, the amounts of the capital stock, and the number of shares into which it is divided, of the banks composing the association.

Third. A declaration that said certificate is made to enable such banks to avail themselves of the advantage of this act.

The said certificate shall be acknowledged before a judge of some court of record or a notary public, and such certificate, with the acknowledgment thereof authenticated by the seal of such court, shall be transmitted to the comptroller of the currency, who shall record and carefully preserve the same in his office. Copies of such certificate, duly certified by the comptroller and authenticated by his seal of office, shall be legal and sufficient evidence in all courts and places within the United States or the jurisdiction of the Government thereof of the existence of such association and of every other matter or thing which could be proved by the production of the original certificate.

SEC. 3. Any banking association organized under the National Bank Act shall be entitled to membership in the clearing house of its district, Qualification of members. organized under this act, on presenting to the said clearing house a certificate from the comptroller of the currency that such association has complied with all the provisions required to be complied with before commencing the business of banking, and that such association is authorized to commence such business; and any banking

association organized under the laws of any State shall be entitled to membership in the clearing house of its district on presenting a certificate from the superintendent of banking of said State that such association has complied with all the provisions of the state law required to be complied with before commencing the business of banking, and that such association is authorized to commence such business; *provided* that such state banking association shall maintain reserves in lawful money as provided in sections 94 to 105 inclusive of chapter five of the National Bank Act, as amended.

SEC. 4. That every association formed pursuant to the provisions of this act shall, from the date of the execution of its organization certificate, be a body corporate, but shall transact no business except such as may be incidental Corporate powers. to its organization, and necessarily preliminary, until authorized by the comptroller of the currency to commence the business of effecting clearances. Such associations shall have power to adopt a corporate seal, and shall have Seal. succession by the name designated in its organization certificate for the period of twenty years from its organization, unless sooner Term of existence. dissolved according to the provisions of its articles of association or by act of the banks owning two thirds of the capital stock represented in the association, or unless the franchise shall be forfeited by a violation of this act; by such name

it may make contracts, sue and be sued, complain
 Contracts, and defend in any court of law or equity
 suits, as fully as natural persons ; it may elect
 officers. or appoint directors, and by its board of directors
 appoint a president, vice-president, treasurer, and
 other officers, define their duties, require bonds of
 them, and fix the penalty thereof, dismiss said
 officers, or any of them, at pleasure, appoint others
 to fill their places, and exercise under this act all
 such incidental powers as shall be neces-
 sary to carry on the business of a clearing
 house for the settlement of money transactions by
 the mutual set-off of debits and credits, commonly
 called making clearances for banks, and by obtain-
 ing and issuing to the banks composing the associ-
 ation notes according to the provisions of this act,
 and by acting as trustee for the note
 holders in accordance with the provisions
 of this act, by receiving and holding in trust secu-
 rities pledged by the members of the association
 as collateral to the notes issued to them, to be
 called "clearing-house currency," and by acting
 for the members of the association in
 their united capacity when authorized to
 do so by a majority vote of said members ; and its
 board of directors shall also have power to define
 and regulate by by-laws not inconsistent
 with the provisions of this act the man-
 ner in which its directors shall be elected or ap-
 pointed, its officers appointed, its property trans-
 ferred, its general business conducted, and all the

privileges granted by this act to associations organized under it shall be exercised and enjoyed ; and its usual business shall be transacted at an office or banking house located in the place specified in its organization certificate.

SEC. 5. That the affairs of every association shall be managed by not less than nine directors, one of whom shall be the president, a majority of whom shall be directors in banks, members of the association, which are organized under the National Currency Act. Every director shall, during his whole term of service, be a citizen of the United States, and at least two thirds of the directors shall have resided in the State, Territory, or district in which such association is located one year next preceding their election as directors, and be residents of same during their continuance in office. Each director when appointed or elected shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association and not knowingly violate, or willingly permit to be violated, any of the provisions of this act, which oath, subscribed by himself and certified by the officer before whom it is taken, shall be immediately transferred to the comptroller of the currency, and by him filed and preserved in his office. At the annual meetings there shall be appointed or elected a loan committee, whose duties shall be as described in sections ten

Directors.

Qualifications of.

Oaths of directors.

Loan committee.

and eleven of this act. Members of this committee shall not be eligible for reëlection or re-
When eligi- ble for re- election. appointment until one year after their terms of office shall have expired. They shall be divided into three classes at their first
Classes of. election or appointment, one third shall serve one year, one third two years, and one third three years, and at every election or appointment thereafter they shall be elected or appointed for a term of three years.

SEC. 6. That the directors of any association first elected or appointed shall hold their places until
Tenure of office of directors. their successors shall be elected and qualified. All subsequent elections shall be held annually on such day in the month of January as may be specified in the articles of association, and directors so elected shall hold
Elections for. their places for one year, and until their successors are elected and qualified; but any director having in any manner become disqualified shall thereby vacate his place. Any vacancy in the board shall be filled by appointment by the remaining directors, and any director so appointed shall hold his place until the next election. If
Failure to hold annual election. from any cause an election of directors shall not be made at the time appointed, the association shall not for that cause be dissolved, but an election may be held on any subsequent day, thirty days' notice thereof in all cases having been given in a newspaper published in the city, town, or county in which the association is located.

If the articles of association do not fix the day on which the election shall be held, or if the election should not be held on the day fixed, the day for the election shall be designated by the board of directors in their by-laws or otherwise: *Provided*, That if the directors fail to fix the day, as aforesaid, banks representing two thirds of the capital stock represented in the association may.

SEC. 7. That in all elections of directors, and in deciding all questions at meetings of members of the association, each bank member shall be entitled to a representation equal to the minimum number of directors allowed by law to said bank, but no bank organized under a state or territorial law shall be entitled to a greater representation at such meetings than that of a national bank. Directors of a bank who shall be appointed to represent said bank at meetings of the association may vote by proxy duly authorized in writing, but no officer, clerk, teller, or bookkeeper of such association shall act as proxy, and no bank any of whose liabilities are past due and unpaid shall be allowed representation in the board of directors or at the meetings of the association.

Representa-
tion of bank
members in
elections.

SEC. 8. That if, upon a careful examination of the facts so reported, and of any other facts which may come to the knowledge of the comptroller, whether by means of a special commission appointed by him for the purpose of inquiring into the condition of such association or otherwise, it

shall appear that such association is lawfully entitled to commence the business of a clearing house as described in this act, the comptroller

Comptrol-
ler's certi-
ficate of
authority.

shall give to such association a certificate, under his hand and official seal,

that such association has complied with all the provisions of this act required to be complied with before being entitled to commence the business of a clearing house under it, and that such association is authorized to commence said business accordingly; and it shall be the duty of

Publication
of certi-
ficate.

the association to cause said certificate to be published in the city or county where

the association is located for at least sixty days after the issuing thereof.

SEC. 9. That the clearing-house association organized under this act, in the chief commercial city

Clearing
houses of
issue.

in each State, or in the city most central and convenient for business in each

State, or any clearing house so organized effecting

One in each
State.

bank clearings of over two hundred million dollars annually, to be designated

and approved by the comptroller of the currency, shall be made a clearing house of issue.

Any with
clearings
of over
\$200,000,000
annually to
be clearing
houses of
issue.

And if there shall be more than one clearing house of issue in a State, then

Comptroller
may divide
States into
clearing-
house
districts.

the comptroller of the currency shall divide the State into clearing-house districts, and banks in each State or district shall do business only with the clearing house of issue in their State or district.

SEC. 10. That a clearing house of issue shall be authorized and empowered to receive from its bank members, or from any bank member of a clearing house within its State or district, with the approval of the directors of said clearing house, commercial assets, promissory notes, bills of exchange, convertible bonds and stocks, and other securities and evidences of debt as collateral security for the circulating notes of the said association, to be issued as provided in this act, and on the approval of the value of said commercial assets by its loan committee, the said clearing house of issue may deliver to said bank member seventy-five per centum of said value in its said circulating notes as an advance upon said pledged property, and shall require from said bank member its promissory note of equal amount, which note shall be in form as approved by said clearing house of issue. The bank member taking said circulating notes shall engage to redeem them in the lawful money of the United States at all times upon demand of payment duly made during the usual hours of business at the office of such bank member, and also when called upon to do so by the clearing house issuing the notes, and to give any additional collateral needed to restore any depreciation in the value of the assets pledged, on demand; and on failure to comply with such demands before the

Powers of clearing house of issue.

May receive bank assets as collateral to currency.

May advance seventy-five per cent. thereon in circulating notes.

Bank member must engage to redeem at all times and give additional security.

close of business hours of the day when made,
said bank member shall be adjudged in
Default.

default, and shall be thereupon closed
pending an examination by a committee from the
association which issued the notes. On recom-
mendation by the examining committee the loan

committee shall proceed to liquidate the
Provision for liquidat- loan by turning the securities into cash,
ing loans. in accordance with the method provided in sec-
tion eleven. The bank member taking said notes

may release its securities from pledge by
Provision for paying depositing with the said clearing house
advances. of issue clearing-house currency, United States
legal-tender notes, or coin certificates, with any
charges made by said clearing house of issue,
whereupon it shall be entitled to and

shall receive all its securities so pledged.
Charges regulated by each clearing house of issue. The charges shall be regulated by each
clearing house of issue. Upon the re-
ceipt of such deposit the clearing house of issue

shall immediately give notice in a news-
Advertise- ment of re- paper published in the city, town, or
demption of circulating notes. county in which the association is located,
which notice shall be published at least once a

week for six months successively, that the notes of
such bank member will be redeemed at par, and
that all the outstanding circulating notes of such

bank member must be so presented for
Must be presented in six years. redemption within six years from the
date of such notice, and all notes which shall not
be thus presented for redemption and payment

within the time specified in such notice shall cease to be a charge upon the funds in the hands of the clearing house for that purpose. At the expiration of such notice it shall be lawful for the clearing house of issue to surrender, and such bank member, or its legal representative, shall be entitled to receive, all the money remaining after such redemption, except so much thereof as may be necessary to pay the reasonable expenses chargeable against the said accounts, including the payment for the publication of the above-mentioned notices.

Bank member entitled to receive money remaining after redemption.

SEC. 11. That each bank member taking such circulating notes shall guarantee the clearing house of issue from loss resulting from such issue to them, and in case of a default in the payment of a loan when demanded by the clearing house of issue or of default arising in any other manner, then it shall be the duty of said clearing house of issue to levy upon all the clearing houses in said State or district, in proportion to the capital of their bank members, a sufficient sum to provide for the payment of said loan, which sum shall be held for the payment and redemption of the circulating notes so issued. And if enough money cannot be obtained by such assessments, then it shall be the duty of said clearing house of issue to report to the comptroller of the currency the fact of said default, and it shall be his duty to levy a further

Guarantee of notes by bank member.

Guarantee by all banks in State or district.

Guarantee by all clearing houses organized under this act.

assessment upon all the clearing houses organized under this act in all the States and Territories until such sum is secured, in which case the funds so raised by the comptroller shall be paid by him to the treasurer of the United States as a special fund to pay the circulating notes of the defaulting

Liquidation
of loans by
comptrol-
ler.

bank member; and he shall appoint a receiver for the collateral securities to the loan or loans in default, who shall

take possession thereof and turn them into cash and distribute the proceeds to the banks which have contributed to the assessment, and any surplus after reimbursing them their advances shall be handed over to the bank member in default or

Liquidation
of loans by
clearing
house of
issue.

its legal representative. But if the assessment by the clearing house of issue on the banks of its State or district is

sufficient to provide the needed funds, then the collaterals shall be administered upon and turned into cash by the loan committee or by a liquidating committee of said clearing house of issue, and the cash proceeds shall be appropriated as above provided. At no time shall the total amount of such

Circulation
limited to
par of capi-
tal stock.

notes issued to any bank member exceed the amount at such time actually paid in of the capital stock of the bank member

so applying. And said loan committee are charged with the duty of supervising said loans

Duties of
loan com-
mittees.

so as to maintain the margin of value of the collateral security, and shall demand

additional securities to make good any depreciation

in their value, and they may allow withdrawals and substitutions of securities which shall not diminish the said value.

SEC. 12. That a clearing house of issue shall be authorized and empowered to receive from its bank members gold coin of the United States of full weight, and may deliver to said bank member its circulating notes at the par of the gold coin so deposited, and the said bank member shall engage to redeem said circulating notes at all times when called upon to do so by the association issuing them. Such notes may be issued to any bank member in exchange for gold coin without regard to the amount of the capital stock of the bank depositing the gold coin. The clearing house of issue shall make report of notes so issued to the comptroller of the currency and shall make no charge for the issue of its notes against the deposit of gold.

U. S. gold coin to be accepted at par and gold issued thereon.

SEC. 13. That in order to furnish suitable notes for circulation as provided in this act, the comptroller of the currency is hereby authorized and required, under the direction of the Secretary of the Treasury, to cause plates and dies to be engraved, in the best manner, to guard against counterfeiting and fraudulent alterations, and to have printed therefrom, and numbered, such quantity of circulating notes, in blank, of the denominations of one dollar, two dollars, five dollars, ten dollars, twenty

Preparation of clearing house currency.

dollars, fifty dollars, one hundred dollars, five hundred dollars, and one thousand dollars, as may be required to supply under this act the associa-

What notes
shall ex-
press.

tions entitled to receive the same, which notes shall express upon their face that they are secured by deposit with the clearing house of issue at (naming the city) of commercial assets at seventy-five per centum of their market value, or of gold coin at its par value, and that said clearing house holds said assets or gold coin as trustee for the note holder to secure their pay-

Payment
guaranteed
by the asso-
ciated banks
of the U.S.
through any
clearing
house.

ment, which payment is guaranteed by the associated banks of the United States through any clearing house, and shall be attested by the signatures of the president or vice-president and treasurer of said clearing house of issue as for account of the bank member receiving said notes; and on requi-

Comptroller
shall furnish
notes.

sition of a clearing house of issue the comptroller of the currency shall forward the amount of blank notes in denominations as called for as may be required to supply the bank member entitled to receive the same under this act.

SEC. 14. That after any such clearing house of issue shall have caused its promises to pay such notes on demand to be signed by the president or vice-president and treasurer thereof, in such man-

Mode of is-
sue of notes.

ner as to make them obligatory promissory notes, payable on demand, such clearing house of issue shall deliver them to the bank

member entitled to receive them, who is hereby authorized to issue and circulate the same as money, and the same shall be received at par at all the clearing houses in the United States organized under this act; and said clearing house of issue shall thereupon forward to the comptroller of the currency a certificate setting forth the amount of notes delivered, the name of the bank member receiving same, and the amount of the collateral security held in trust for their redemption.

Notes to be received at par at all clearing houses.

Amount of issues and collateral therefrom to be certified to comptroller.

And every bank member of every clearing house organized under this act shall take and receive at par, for any debt or liability to it, any and all notes or bills issued by any clearing house of issue organized under this act.

Notes to be received by all banks for any debts due them.

The meeting together of any persons who are officers, agents, or employees of persons, firms, or corporations in any one or more places once in thirty days or oftener, for the purpose of exchanging, paying, or in any other way satisfying any obligations used in commerce among the several States by any two or more of such persons, firms, or corporations, or for the purpose of the settlement of money transactions by the mutual set-off of debits and credits, commonly called making clearances for banks, shall constitute such persons, firms, or corporations represented in such meeting a clearing-house association, for the pur-

Definition of clearing house.

pose of the taxation herein imposed, and such persons, firms, or corporations represented shall be jointly and severally liable to pay, and shall pay, into the Treasury of the United States a duty in amount equal to one one-fiftieth of one per centum on

Tax on clearing houses not organized under this act.

the aggregate amount of all such obligations exchanged, paid, or in any way satisfied, or on the aggregate amount of the money transactions settled by the mutual set-off of debits and credits, at each and every meeting of persons acting for such persons, firms, or corporations: *Provided, however,* That in case any such clearing-house association pays one half of the tax herein imposed on or before the day it is due and payable, the other half

Remission of such tax.

shall be and is hereby remitted: *And provided further,* That the tax herein imposed on clearing-house associations herein described shall be wholly remitted to all members of clearing houses that are incorporated under this act.

SEC. 15. That it shall be the duty of the clearing house of issue to receive worn-out or mutilated

Reissue for worn-out or mutilated circulations.

circulating notes issued by it to any bank member, and also, on due proof of the destruction of any such circulating notes, to deliver in place thereof other circulating notes of like tenor and amount. And such worn-out or mutilated notes, after a memorandum shall have been entered in the proper books, as may be established by the clearing house of issue, as well

as all circulating notes which shall have been paid or surrendered to be canceled, shall be burned to ashes in presence of three persons, one to be appointed by the comptroller of the currency, one by the clearing house of issue, and one by the bank member on whose account they were issued; and a certificate of such burning shall be made on the books of the clearing house of issue, and duplicates forwarded to the comptroller of the currency and to the bank member whose notes are thus canceled.

SEC. 16. That it shall be unlawful for any officer acting under the provisions of this act to countersign or deliver to any association or to any other company or persons any circulating notes contemplated by this act, Penalty for improper delivery of notes. except as hereinbefore provided and in accordance with the true intent and meaning of this act. Any officer who shall violate the provisions of this section shall be deemed guilty of a high misdemeanor, and on conviction thereof shall be punished by fine not exceeding double the amount so countersigned and delivered and imprisonment not less than one year and not exceeding fifteen years, at the discretion of the court in which he shall be tried.

SEC. 17. That it shall be lawful for any such association to purchase, hold, and convey real estate as follows: —

First. Such as shall be necessary for its immediate accommodation in the transaction of Real estate. its business.

Second. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

Third. Such as shall be conveyed in satisfaction of debts previously contracted in the course of its dealings.

Fourth. Such as it shall purchase at sales under judgment, decrees, or mortgages held by such association, or shall purchase to secure debts due to said association.

Such association shall not purchase or hold real estate in any other case or for any other purpose than as specified in this section, nor shall it hold the possession of any real estate under mortgage, or hold the title and possession of any real estate purchased to secure any debts due to it for a longer period than five years.

SEC. 18. That the plates and special dies to be procured by the comptroller of the currency for the printing of such circulating notes shall remain under his control and direction, and the expense necessarily incurred in executing the provisions of this act, respecting the procuring of such notes and all other expenses of the bureau, shall be assessed each year upon the clearing houses organized under this act, in proportion to the capital stock of their members.

Control of
plates and
dies.

Expense to
be assessed
on clearing
houses.

SEC. 19. That the comptroller of the currency, with the approbation of the Secretary of the Treasury, as often as shall be deemed necessary or

proper, or at the request of any clearing house, shall appoint a suitable person or persons to make an examination of the affairs of every association organized under this act, which person shall not be a director or other officer in any association whose affairs he shall be appointed to examine, and who shall have power to make a thorough examination into all the affairs of the association, and in doing so to examine any of the officers and agents thereof on oath, and shall make a full and detailed report of the condition of the association to the comptroller, who shall fix the compensation for his services.

Clearing-house examiners.

SEC. 20. That every president, director, treasurer, teller, clerk, or agent of any association who shall embezzle, abstract, or willfully misapply any of the moneys, funds, or credits of the association, or shall, without authority from the directors, issue or put in circulation any of the notes of the association, or shall, without such authority, assign any note, bond, draft, bill of exchange, mortgage, judgment, or decree, or shall make any false entry in any book, report, or statement of the association with intent in either case to injure or defraud the association, or any other company, body, politic or corporate, or any individual person, or to deceive any officer of the association, or any agent appointed to examine the affairs of any such association, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall be punished by imprisonment not less than five nor more than ten years.

Penalty for official malfeasance.

SEC. 21. That every person who shall mutilate, cut, deface, disfigure, or perforate with holes, or shall unite or cement together, or do any other thing to any note issued by any such association, or shall cause or procure the same to be done, with intent to render such note unfit to be reissued by said association, shall, upon conviction, forfeit fifty dollars to the association who shall be injured thereby, to be recovered by action in any court having jurisdiction.

SEC. 22. That if any person shall falsely make, forge, or counterfeit, or cause or procure to be made, forged, or counterfeited, or willingly aid or assist in falsely making, forging, or counterfeiting, any note in imitation of, or purporting to be in imitation of, the circulating notes issued under the provisions of this act, or shall pass, utter, or publish, or attempt to pass, utter, or publish, any false, forged, or counterfeited note, purporting to be issued by any association doing business under the provisions of this act, knowing the same to be falsely made, forged, or counterfeited, or shall falsely alter, or cause or procure to be falsely altered, or willingly aid or assist in falsely altering, any such circulating notes, issued as aforesaid, or shall pass, utter, or publish, or attempt to pass, utter, or publish, as true, any falsely altered or spurious circulating note issued, or purporting to have been issued, as aforesaid, knowing the same to be falsely altered or spurious, every such person shall be deemed

Penalty for
mutilating
currency.

Penalty for
counterfeit-
ing circula-
tion.

and adjudged guilty of felony, and being thereof convicted by due course of law shall be sentenced to be imprisoned and kept at hard labor for a period of not less than five years nor more than fifteen years, and fined in a sum not exceeding one thousand dollars.

SEC. 23. That if any person shall make or engrave, or cause or procure to be made or engraved, or shall have in his custody or possession any plate, die, or block after the similitude of any plate, die, or block from which any circulating notes, issued as aforesaid, shall have been prepared or printed, with intent to use such plate, die, or block, or cause or suffer the same to be used, in forging or counterfeiting any of the notes issued as aforesaid, or shall have in his custody or possession any blank note or notes engraved and printed after the similitude of any notes issued as aforesaid, with intent to use such blanks, or cause or suffer the same to be used, in forging or counterfeiting any of the notes issued as aforesaid, or shall have in his custody or possession any paper adapted to the making of such notes, and similar to the paper upon which any such notes shall have been issued, with intent to use such paper, or cause or suffer the same to be used, in forging or counterfeiting any of the notes issued as aforesaid, every such person, being thereof convicted by due course of law, shall be sentenced to be imprisoned and kept to hard labor for a term not less than five nor more than fifteen years,

Penalty for
illegal pos-
session or
use of mate-
rial for cir-
culation.

and fined in a sum not exceeding one thousand dollars.

SEC. 24. That it shall be the duty of the comptroller of the currency to report annually to Congress at the commencement of its session : —

First. A summary of the operations and condition of every association from whom reports have been received the preceding year, at the several dates to which such reports refer, with an abstract of the whole amount of their debts and liabilities, the amount of circulating notes outstanding, and the total amount of means and resources, specifying the amount of lawful money held by them at the times of their several returns, and such other information in relation to said associations as in his judgment may be useful.

Second. A statement of associations whose business has been closed during the year, with the amount of their circulation redeemed and amount outstanding.

Third. Any amendment to the laws relative to clearing houses, by which the system may be improved, and the security of the holders of their notes may be increased.

Fourth. The whole amount of the expenses of carrying out the provisions of this act. And such report shall be made by or before the first day of December in each year, and the usual number of copies, for the use of the Senate and House, and one thousand for the use of the department, shall

be printed by the public printer and in readiness for distribution at the first meeting of Congress.

SEC. 25. That the clearing houses organized under this act may organize among themselves associations to include the banks mem- State bank-
ers' associa-
tions. bers thereof in any State or district, and may hold annual conventions and meetings at other times, for the formulation of rules and regulations for the conduct of their affairs and for the discussion of financial subjects and for the preservation and exchange of information to govern the granting of credits, and when approved by the Secretary of the Treasury, such rules and regulations shall be binding upon the banks and clearing houses within said State and district.

SEC. 26. That clearing houses organized under this act may form a national association, which shall meet in convention annually, and National
bankers' as-
sociations. whose object shall be the promotion of the interests of the banks of the United States receiving the benefits of this act, and said convention may pass rules and regulations to govern the operations of clearing houses and the banks connected with same, which, when approved by the Secretary of the Treasury, shall be binding upon such clearing houses. The delegates to a state or district convention shall number one hundred, and to a general convention three hundred, which numbers divided into the aggregate of the banking capital represented will give in each case the amount of capital to be taken as the basis of

representation. The comptroller of the currency may unite banks into voting groups where their separate capital is below the basis of representation, and each group shall be entitled to one representative. All elections of representatives to conventions shall be by a majority vote of the directors entitled to vote of single banks and banks composing groups ; each bank shall have a vote equal to the minimum number of directors allowed to it by law, but no bank shall be allowed more votes than shall be given to a national bank, and no bank shall have more than one representative in the national association.

Mr. Gilman addressed the committee as follows :

STATEMENT OF MR. GILMAN

MR. CHAIRMAN AND GENTLEMEN OF THE COMMITTEE : In response to the request of the chairman, I will state that my place of business is in New York City. I have been a banker there ever since 1862. My relations have been all over the country, East and West, chiefly outside of New York City.

The CHAIRMAN. A private banker ?

Mr. GILMAN. Yes, sir.

The CHAIRMAN. What is the firm name ?

Mr. GILMAN. Gilman, Son & Co.

With your leave I will read this letter : —

THE STATE BANK OF ST. LOUIS,
ST. LOUIS, MO., April 9, 1898.

Hon. J. H. WALKER,

Chairman Banking Committee,

House of Representatives, Washington, D. C.

DEAR SIR: I see your committee are to meet on the proposed emergency currency plan of Mr. Theodore Gilman on the 13th instant. I am of the opinion that some plan for such a currency ought to be passed.

You will find in Mr. Gilman's book a few suggestions made by me regarding such a currency and a schedule regarding same.

If we could have had a hundred millions of such currency in 1893 it would have saved half or two thirds the ill effects of the panic. It may be the present Cuban trouble will make some such measure invaluable now. I can but think something in this direction can be made of immense value to the country.

Very respectfully yours,

CHARLES PARSONS.

I would like to make two remarks about this letter. One is I was immediately struck with the similarity of this opinion of Mr. Parsons to that of Mr. J. R. McCulloch in 1849 in reference to the panic of 1837.

THE CHAIRMAN. Mr. McCulloch who was formerly Secretary of the Treasury?

MR. GILMAN. No; Mr. McCulloch of London, the great British financial authority. He wrote that had this principle of a secured currency been adopted then, the crisis of 1837 to 1839 would have been obviated or materially mitigated. Fifty

years afterwards Mr. Charles Parsons makes the same remark in reference to the panic of 1893.

The CHAIRMAN. We would be glad if, when you refer to different gentlemen, you would state what positions they hold or who they are.

Mr. GILMAN. Charles Parsons is president of the State Bank of St. Louis, Mo., and a former president of the American Bankers' Association. I would also call your attention to the last three words of Mr. Parsons's letter — "to the country." He says: "I think something in this direction can be made of immense value to the country." He speaks as a patriot and not as a banker.

Mr. Gilman then proceeded to read a paper which he had prepared, as follows: —

TWO SYSTEMS OF BANKING

MR. CHAIRMAN AND GENTLEMEN: There are only two systems of banking in use among civilized nations. One system is that in which each bank has a separate individual existence under the laws by which it is incorporated, and in which no bank has a superior position or different functions from any other.

The other system is that in which some banks have different functions and a superior position.

The perception of this distinction is necessary to the right understanding of the phase of the banking question we are about to consider, and as examples assist in the understanding of abstract propositions, your attention is called to the fact

that there are now in the hands of this committee two bills which represent these two systems. One is the bill H. R. 9725, prepared by your sub-committee and introduced in the House of Representatives on April 5, 1898, and the other is bill H. R. 9279, which is the subject of the present hearing. Bill H. R. 9725 represents a system composed of individual banks, and bill H. R. 9279 represents a graded system.

THE COMPETITIVE SYSTEM

The fundamental points of difference between these two systems may be briefly summed up as follows: While bill H. R. 9725 has incorporated in it some special features, which will be hereafter considered, it does not depart from or change the chief characteristic of the National Bank Act, which is that it provides for individual independent banks, with no relations to each other, and dependent for their solvency upon a cash reserve of a certain percentage of their obligations. From this it necessarily results that in a time of stringency each individual bank becomes a competitor with every other bank for the cash needed to replenish and maintain its reserves, and the only legal means for keeping up the required percentage of lawful money is by restricting discounts and loans and compelling the business public to liquidate and pay up. The methods of this system all naturally gravitate toward and end in panic. Proper names for this system are the

ungraded, or competitive, or restrictive, or "panic system," according as its different characteristics are to be emphasized.

THE COÖPERATIVE SYSTEM

Bill H. R. 9279, on the other hand, provides for the incorporation of clearing houses with limited functions, differing from the existing national banks, but organically connected with them, chief among the functions given to the clearing houses being that conferred upon at least one in each State, which empowers such clearing house to receive from its bank members, and to hold as trustees for the public, bank assets, and to issue thereon, at seventy-five per cent. of their ascertained value, circulating notes good at any clearing house in the land. The object of this provision is to sustain commercial and banking credit in times of lack of confidence, by providing a means by which demands for circulating notes of undoubted credit may be met, and thereby commerce and trade be sustained without shock to credit.

By this system functions are bestowed on clearing houses which are not and cannot be safely possessed by commercial banks. Clearing houses are one remove farther away from the business community with their urgent appeals than are popular banks, and their action would therefore be more conservative in this all-important matter of the issue of currency. At the same time they are so closely connected with commercial banks that they

can be appealed to and can make instant response in case of need. By the incorporation of clearing houses under a federal law with these special functions, a banking system is constituted, and it is made coöperative instead of competitive, expansive in case of need, instead of restrictive, and forced liquidations and panic are avoided. The clearing houses of the country are thus brought into the closest relations with all commercial banks, those relations are strictly defined by law, which now they are not, and this union of higher and lower brings all banking operations under the supervision of the government, constituting a true national banking system.

The methods of the system so constituted all conspire toward and result in sustaining and protecting commercial credit even under the severest test. Proper names for this system are a graded or coöperative or expansive system, or a system of ample available bank reserves.

THE COMPETITIVE SYSTEM FOR PRIVATE PROFIT,
THE COÖPERATIVE FOR THE BENEFIT OF THE
PUBLIC

There is another difference between these two systems more fundamental and important. It is that the ungraded, competitive, restrictive, panic system is principally constructed for the private pecuniary benefit of the individual banks, while the graded system, with its coöperation, expansion, and ample available reserve, is chiefly for the

benefit of the public. Webster said, "Banks are made for the borrowers. They are made for the good of the many and not for the good of the few." The trend of the provisions of the ungraded system is for the protection and profit of the individual bank even to the extent of causing for its protection widespread losses to the commercial public by panic and forced liquidation, while the provisions of a graded system have as their chief object the protection and support of the business interests of the public. These two bills now before this committee are, therefore, in their ultimate analysis, the one, H. R. 9725, a bill for private ends and profits, and the other, H. R. 9279, a bill for the benefit of the interests of the public.

TWO NEW FEATURES IN BILL 9725

A clear understanding of this latter bill, H. R. 9279, for which this hearing is given, will be promoted by incidentally explaining and describing the true nature of the former.

It has already been said that an examination of bill H. R. 9725 shows that it does not change the banking principle contained in and limited by the present National Bank Act. The bill adds, however, two features not contained in that act, by proposing the issue of reserve notes to take up government notes, and the issuing of circulating notes against bank assets in the hands of the banks.

These are details which are not distinctive and

which might be added to any other system or to this system at any other time. Their addition might be approved by some and disapproved by others, but they are only modifications of the present national banking system, and they leave it in its fundamental features just as at present, a series of separate individual banks numbered from one up to over three thousand, and each bank is like every other in all its powers, privileges, and functions.

RESERVE NOTES

It is hardly necessary to consider the feature of the bill which provides reserve notes of banks in place of government notes, because the fundamental principle of the system is not changed thereby. Also the obligation of the government regarding the reserve notes is only suspended or dormant, and on the failure or liquidation of a national bank it revives. The relief from the burden of redemption is, therefore, only temporary. The obligation would be certain to revive at a time when banks generally would be in trouble, and then the plague of redemption would exist as before and under the most unpropitious circumstances.

The government is too big to hide behind the banks. It must take care of itself. It has had an Independent Treasury since 1840, and no step should now be taken to obliterate the strong line of division between the fiscal operations of the government and the commercial business of the people.

UNSECURED BANK NOTES

Nor is it worth while seriously to consider the issue of circulating notes by three thousand separate individual banks against securities in their own possession, because that also does not change the character of the old system. Moreover, the principle of a currency, secured by assets in the hands of a trustee, has become too thoroughly ingrained in the thoughts of the people to admit of being dislodged at the present time. Bank notes on assets in the hands of banks are the most explosive form in which bank credit can be put, and bills issued by three thousand banks would be certain to produce and aggravate a panic. Why does not the bill provide that these notes shall be accepted by all national banks at par? Is it because they are good enough for the people but not good enough for the banks?

These two features of reserve notes and unsecured bills are joined together, and the banks are required by the bill to incur the obligation of redeeming the debt of the government assumed by them as a compensation for the privilege of an unsecured note issue. The inducement held out to the banks to do this is the privilege of note issues on their own assets. This is a great concession, and a good source of income to banks, but a fruitful one in losses to the public.

THE PUBLIC, NOT THE BANKS, SUFFER FROM
CONTRACTION

Experience has shown that banks can exercise the function of unsecured note issue and continue to pay dividends even though the public suffers from the resulting panic. In 1837 the banks continued to pay dividends while the country was ruined by the liquidation caused by the retirement of their note issues. Banks have a claim equal to a mortgage on the property of the community, and if a demand for money occurs, they can force liquidations and get back the money loaned, though the borrower is forced to the wall. Unsecured note issues contract with greater rapidity than any other form of bank credit, and are the greatest source of danger to the business community, but the banks themselves do not suffer from the contraction. So the privilege of note issue on assets in their hands is coveted by banks, and it is used in bill H. R. 9725 to induce them to assume the obligations of redeeming government notes, which, in the report on this bill, is acknowledged to be a heavy burden.

Granting all that is said in the report of your special sub-committee as to the safety of unsecured notes, the chief argument against them is left unanswered, that they are like scythes to mow down the business which the banks have created. As Governor Marcy said, in his message of January 3, 1837, of an unsecured paper circulation, this is

an evil "against which it is the duty of the legislature to afford ample and certain protection."

TRUE NAME, "THE PANIC SYSTEM"

Bill H. R. 9725 is, therefore, the present competitive, restrictive, panic system of banking, with two additional features,—the assumption of the payment of government notes and the issue of notes on assets in the hands of each one of the three or four thousand banks. Whether or not these two features are a recommendation or a disadvantage, the underlying, fundamental, controlling characteristic of the banking system contained in or proposed by the bill H. R. 9725 is the same as contained in the National Bank Act; that is, one of separate, individual banks, no one of which is different in any respect from any other.

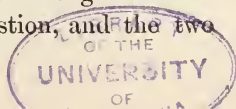
There is no coöperation between banks proposed in the bill, and in case of panic each of the three thousand banks must fight for its own life. This produces restriction of banking facilities at the first sign of monetary disturbance, nor is there any provision for the support of commercial credit in time of panic. The true name for such a system is the "panic system."

GOVERNMENT FINANCES SHOULD BE INDEPENDENT

I am not here to criticise this bill, and I only point out its chief characteristics as I understand them, that this committee may see clearly what is

proposed to accomplish by bill H. R. 9279. That bill, which is the subject of the present hearing, is a banking and currency measure, and has nothing to do with the finances of the government. These two subjects should be kept distinct. The independence of the United States Treasury from the banking operations of the people was established, as I have said, in 1840, and the advantages resulting to the government from this separation have been almost universally acknowledged. The financial principle seems well established that the government should take care of its obligations, and corporations created by the government of theirs.

If the government is in need of revenue to defray its expenses in peace or in war, it must find the ways and means to raise a revenue sufficient to meet them. If the demand notes of the government are presented in excess of the ability of the Treasury to pay them in coin, the government must find the ways and means to replenish its coin reserve. If Congress should decide not to make such provision, the banks must accept that decision, for they are powerless to change it. Their province is to do business in the currency which the government provides, not to decide what that currency shall be. The laws of banking govern banking operations whether the currency is silver or gold or an irredeemable paper money. The whole matter of the currency of the government is outside of the banking question, and the two



should be separated and taken up and decided apart from each other. The banking system should not be the battlefield for warring currency factions.

Banking and currency are matters relating to corporations created by the government and relating to the people, all of whom are persons and subjects of the government, and to their commercial transactions, so no apology is needed for asking the attention of the Committee on Banking and Currency to a bill which treats only and exclusively of banking and currency.

BENEFITS OF A GOOD BANK CURRENCY

While government and bank currency are two distinct questions, it is also true that a good banking currency will aid the country in maintaining a good government currency. If the bank currency sustains and protects commercial credit, there will be less discussion of the money question. A good bank currency would give the advocates of silver and fiat money all they are striving for, while they would be grievously disappointed with the result of free silver and unlimited government currency. The inflation caused by free silver or fiat money would take place once, and that would be the end of it. A few would be made rich, but it would not be the farmer, nor cotton grower, nor mechanic. Can the people of a mining State be sure that those who would amass fortunes would remain in those States to spend them?

Would they not come East or go to London or Paris?

But a good banking system would remain in the State to perform its functions season after season and year after year, conveying the lifeblood of commerce through the veins and arteries of the body commercial that are now well-nigh bloodless and paralyzed. Free silver could not benefit a mining State as free banking facilities could. "Credit," said Daniel Webster, "has done more a thousand times to enrich nations than all the mines of all the world." So a bill to protect credit will do more to enrich the United States than its mines can ever do.

NATIONAL BANK ACT SHOULD STAND WITHOUT
AMENDMENT

Bill H. R. 9279 does not disturb or conflict with the National Bank Act. It is supplementary to it. Popular banks are provided for in the National Bank Act, and the measure now under consideration proposes that that act shall stand without amendment. The National Bank Act is admirable in all its provisions; it is the flower and fruit of republican banking legislation; it has served the people well these thirty-five years, it has their confidence, and is enshrined in their affections. A change in that act would be most risky and most serious. Moreover, no changes are required in it, for it is difficult to see how a general law could be made more perfect. Also

hundreds, and perhaps thousands, of legal decisions have been rendered by the courts defining the meaning of its various sections, successive Congresses have revised and amended it, and digests have been made of these decisions and amendments until a code of banking law has grown up in these thirty-five years around the National Bank Act which is one of the most valuable products of our national legislation. To lose all this, to sweep it away with a new national bank act, would inflict such a loss on our people that it should not be thought of except under the direst necessity. No such necessity exists. What is needed is to complete the national banking system, not to change it. Bill H. R. 9279 proposes to do that by incorporating our clearing houses under a federal law, thus bringing all banking operations under federal supervision and control.

COMPLETION OF NATIONAL BANKING SYSTEM

The conception of the framers of the National Bank Act is thus fulfilled by taking the last step necessary to bring all the banking operations of the country into the one system. When clearing houses are thus incorporated under a federal law, it will be safe to give to them special functions which cannot be conferred safely on popular banks, chief among which is the power to act as trustees for the public by holding in trust securities pledged by popular banks against which circulating notes may be issued at seventy-five per cent. of their

ascertained value, good and receivable at any clearing house in the nation.

This function can be safely given to at least one clearing house in each State, so as to secure a local issue of currency, and the exercise of this function will remedy the only defect in our banking system, which is the absence of the power of self-preservation and of the protection of commercial credit. This change would make it impregnable, and, like our judicial system, the foremost among the banking systems of all the nations of the earth.

THE PROTECTION AND SUPPORT OF COMMERCIAL CREDIT

If it is asked what is the reason for this addition to our banking laws, the answer is, because there is no provision in the National Bank Act for the support of commercial credit, and none is proposed in bill H. R. 9725 ; and for lack of such support we have seen of late years successive panics march over our land, destroying and prostrating business almost to the point of the exhaustion of the country. Every emergency or disaster, or war or rumor of war, reveals the weakness of our system, which trembles at the first approach of danger, because it is conscious of its lack of protection.

The great business need of our country to-day is the assurance of the protection of commercial credit.

COMMERCIAL CREDIT DEFINED

The bill which is the subject of this hearing has for its chief object to support commercial credit. By commercial credit is meant the solvency of solvent individuals, firms, and corporations engaged in commerce and finance. To support the credit of solvent parties is to provide means and measures to insure their solvency. Solvency is that state of a sound concern, be it corporation, firm, or individual, in which it is able to provide the money necessary to carry on its business and meet its obligations out of its cash on hand, or upon sales of its notes or property, or by loans thereon.

Insolvency may overtake a concern by reason of losses and misfortunes, or insolvency may occur when the concern has met no losses and has ample bank balances to its credit and its hands full of good assets, but owing to a monetary disturbance it cannot draw money from the bank or find purchasers for its property, however low the price may be fixed, or obtain loans on its notes, however well secured by valuable assets. The support of commercial credit, which this bill contemplates, is that of solvent concerns who can make good and valid obligations, and who can offer abundant assets as security for loans, and of whose credit and ultimate solvency there can be no question.

It might appear that strong parties, individuals, firms, and corporations of the kind described are not in need of protection, but are amply able to

take care of themselves, and it therefore becomes necessary to show that our present banking system does not contain provisions to afford this class sure protection to their solvency, nor does bill H. R. 9725 contain such.

CREDIT MAINTAINED BY CASH RESERVES

It is first necessary to mention the fact that all business is done on the credit system ; that every concern or individual having a surplus of unemployed cash will seek immediately to invest in some productive employment as much of its idle cash as may not be needed, retaining only so much thereof as may be required to meet demand calls. This is the universal practice in all business, whether commerce, manufacture, agriculture, mining, banking, or any other employment. Each department of business has its rule as to the safe amount which can be invested in a permanent way and what percentage of cash may be required to insure ability to meet all demands for cash. This percentage of idle or uninvested money each concern calls its reserve. The continual question among all corporations and business men is as to the amount of cash which should be kept on hand to insure solvency. On the one hand, there is the necessity of solvency, and on the other the desire to keep all capital employed, and there is a continual strife between the two. The difficulty in arriving at the correct ratio is so great that it has been found necessary to regulate by statute the percen-

tages of reserves which shall be carried by banks and insurance companies.

THE CREDIT SYSTEM UNIVERSAL

This survey shows that the whole business community is conducting its business of every shape and description on the credit principle. The basis of the idea of credit is that the business world has confidence that a firm or corporation can conduct its business safely with a cash reserve and that markets and banks will be open for sales and loans to provide all its possible needs.

There is a mutual dependence of all departments of business each upon the other, and if this co-operation does not exist solvency cannot be maintained. Reserves must be kept up and be available, or solvency is destroyed. Markets must be open, or business comes to an end. Banks must be able to discharge all their functions, or business must be suspended and markets must be closed.

All business being thus mutually dependent and transacted on the principles of the credit system, it follows that each one and all of the 1,080,000 firms, corporations, and individuals engaged in business in the United States, according to mercantile reports, are doing business on credit, all have a cash reserve, greater or smaller, and all have assets, which in case of need they would turn into cash, either by sale or direct pledge or by making paper against them if their standing and responsibility would enable them to do so.

It can be safely said that there are no firms, individuals, or corporations doing business in the United States on a strictly cash basis ; that is, no firms have all their cash in coin in their own custody and pay coin for all purchases and sell only for coin on delivery. A firm doing business in that manner would soon find itself distanced by competition and unable to make money.

CREDIT SYSTEM MUST BE PROTECTED

The basis of all business in the United States being the credit system, every business man is vitally interested in having the credit system work smoothly. He first wants to be absolutely sure that his reserve, which he calls his cash on hand, is at all times subject to his demand. This means that the banks which are the custodians of his cash shall be at all times ready to respond to his calls, even if he should ask for the payment of all that is due him.

He wants, secondly, that in case of need he shall be able to increase his cash means by pledge of either his credit or his assets for a temporary loan if the cash reserve he has provided has been diminished or exhausted, and, thirdly, he wants the markets open so that he may sell his property without sacrifice on the basis of a fair return to himself and a fair equivalent to a buyer.

ALL THE NATION INTERESTED

This describes the condition and business wants of the 1,080,000 individuals, firms, and corporations doing business in the United States. Of these there are about 10,000 banks and 1,070,000 other concerns and individuals.

These 1,070,000 individuals, firms, and corporations represent those who are the owners of the manufactories, trading companies, and firms of the manifold descriptions which go to make up the various occupations of the people of the United States. They are the ones who give employment to the 2,500,000 employees engaged in railroad and other transportation ; they pay the wages of the 5,000,000 operators in our factories of all kinds ; they hire the 4,200,000 women and men who are engaged in domestic and personal service ; they ultimately pay the salaries of the 1,000,000 men and women engaged in professional work. They are the busy, thinking, energetic, active, pushing men who are doing the manufacturing, merchandising, and trading of our country, and the welfare of their employees and dependents, and thus of the whole country, rests on the orderly working of the credit system. If a panic comes to upset that system, then distress is felt not only by the 1,070,000 individuals, firms, and corporations engaged in business, but by all their dependents ; and the legislators who can devise and enact a law which will support the credit system will

confer a benefit on every man, woman, and child throughout the nation.

This view of reserves is from the standpoint of the 1,070,000 concerns who make up the business community. We sometimes limit reserves to the idle cash held by banks, but in a true sense every business concern has its separate reserve, and it is represented by its bank balance or quick securities. Bank balances should be regarded as the reserves of the country.

PRESENT BANKING SYSTEM PRECARIOUS

We can now see how precarious is the monetary situation in the United States if the country banks, as they are permitted to do under the National Bank Act, immediately lend out from 75 to 85 per cent. of these reserves and then send one half or two thirds of the remaining cash to reserve agents, who in turn loan out 75 per cent. of the cash reserve sent to them and hold the balance, not as a special fund for the benefit of the banks whose reserve it is, but merge it into their common reserve on all their general deposits, and at the same time have no way of repaying the reserves thus confided to them if an emergency arises, except by forcing liquidations on the borrowing public. The banks hold the reserves of the public ostensibly on demand and then put 80 per cent. thereof beyond their call. This practice is a distinct weakening of the banking situation if there is no way by which the banks can get back this money except by distressing borrowers.

Suppose it should happen that all the deposit reserves should be called for by out-of-town banks, then a simple calculation shows that the banks in reserve cities would be left with hardly more than five per cent. in cash on their remaining deposits, which would then amount to about \$750,000,000.

This state of affairs would be very alarming in any less intelligent country than the United States, and it exposes even us to a constantly recurring liability to spasms of apprehension and panic, during which the three objects desired by the business community and necessary for the support of the credit system are imperiled, viz., the payment of bank balances in cash, the granting of needed loans to the business community, and the keeping of markets open.

PROTECTION TO CREDIT BY A SOUND CREDIT CURRENCY

The simple expedient necessary to prevent this liability to apprehension is to enact laws to protect reserves, not only the reserves of the banks, but the reserves of the business community represented by bank deposits, and to give banks the power to grant accommodations as needed.

The power to issue a credit currency will do this, provided it is, as Professor Sumner expresses it, "of a credit which cannot fail in the wildest panic."

A credit currency issued by three thousand local banks on assets in their own hands, as proposed in

bill H. R. 9725, would not answer. In a wild panic that would fail. It must have a credit second only to the government, which will enable it to circulate freely from one end of the country to the other, because it is to do the service of maintaining the reserves of all the 1,070,000 individuals, firms, and corporations who are bearing the business burdens of the entire country and are paying the salaries and wages of the 15,000,000 to 17,000,000 workers, men and women, engaged in honest labor. It must be a currency which will go at par from Maine to Texas and up to the farthest point of Alaska. It must be able to support the credit of a solvent firm or corporation in Massachusetts by paying a debt due in Iowa, or vice versa. The transactions under the credit system are so interlaced and interwoven all over the country that that system cannot be supported except by a currency of universal credit. The clause in the charter of the Bank of France states it plainly thus: "The essential interests of the country imperiously demand that every bank bill declared to be lawful money shall be able to circulate equally in all parts of the land."

EFFECTS OF APPREHENSION

Whenever a spasm of apprehension comes, which of late years has been almost a chronic condition, the banks stop lending or discounting and thus stop much productive business. That is the first effect. By it the availability of the collateral

security reserves of business houses in the shape of bonds and dividend-paying stocks is cut off, and they must depend on their cash or bank deposit reserves only. If the apprehension deepens, even the use of this cash reserve is diminished; and a next step is taken when the banks find it necessary to strengthen their own cash reserve by absorbing cash from the general public. The movement is a progressive one, and the tightening goes on until enough of the life blood of commerce is squeezed out of the general public to restore reserves and to relieve the banks of the danger caused by the paucity of their cash on hand.

The diminution of the reserves of business houses must take place at the same time with a diminution of bank reserves — that is, loans are wanted when banks are least able to respond. The demand always comes when the supply is lowest. The mode by which this dilemma may be avoided is by the creation of money to serve for the temporary emergency.

The bank has no money to lend, its cash being reduced to the lowest percentage of required reserves; but the borrower has good security and needs money.

RELIEF THROUGH INCORPORATED CLEARING HOUSES

It is in this juncture that the measure proposed in bill 9279 would bring relief. Under the restrictive system the borrower would have to go

without, and he would sacrifice just so much of his property as was necessary to maintain his solvency. In an active business this frequently causes a final liquidation, which is commercial death. But with a system of incorporated clearing houses, such as is proposed in bill 9279, such a contingency could not occur. Banks could always get advances to enable them to pay depositors and to lend customers all the money needed for legitimate purposes.

Clearing houses incorporated under a federal law, as proposed in this bill, would be authorized to receive bank assets from their bank members, and advance seventy-five per cent of their estimated value in notes created for the purpose, whose credit could not be questioned from Maine to Alaska, because the notes are receivable at any clearing house in the land, and there is a trustee to act for the note holder who has in his possession ample collateral security, and whose faithfulness to his trust cannot be questioned. That trustee is the clearing house. This is not an inflation, or the creation of capital, for that existed before in the security, but it is a change of its form into a circulating medium, on the assumption that when the round is performed by the circulating notes the borrower will have disposed of enough property in the ordinary course of his business to secure the cash needed to retire the notes. This is a most beneficent operation from every point of view, as it benefits every one concerned therein and is done

with entire safety to all. The proof of its goodness is that it may be done to any extent which legitimate business demands.

IDEA SUGGESTED BY CLEARING-HOUSE CERTIFICATES

The idea of this form of currency was suggested by clearing-house certificates, with which the public has become familiar in recent years. The methods which have been so successful in producing absolute safety in these certificates have been applied to the proposed currency. The object aimed at was to produce as strong a currency as the banks could make, so that it could not fail to be good in any panic.

If the unsecured notes of three thousand banks are good, as said in the report of your sub-committee, these secured notes of forty-five state clearing houses would be immeasurably better.

DIFFERENCE BETWEEN CLEARING-HOUSE CURRENCY AND CERTIFICATES

The great difference between clearing-house currency and clearing-house certificates is that in one case the currency is paid out and the reserves are kept intact, while in the other the precious reserves are paid out and the certificates held in their place. This latter act is an infraction of the law as to reserves which the country winks at. Clearing-house certificates cannot be used to any extent outside of the great centres, and they are a

dangerous resource at all times, while clearing-house currency could be used everywhere and at all times with safety.

Clearing-house currency is therefore a source of strength to banks, while clearing-house certificates are an evidence of weakness.

Another difference is that clearing-house currency would forestall and prevent a panic, while certificates are issued after a panic has taken place. One is preventive, the other is remedial. The old saying is very true that an ounce of prevention is worth a pound of cure.

Clearing-house currency, therefore, is not an experiment, for the limited and extra-legal form of clearing-house certificates has many times brought safe and certain relief to banks in reserve cities. Should not that be legalized which has been well done extra-legally, and should not the benefit of the relief be given to all the country which has hitherto been enjoyed by only a part?

WITHDRAWAL OF BANKING FACILITIES CAUSES PANIC

Times of apprehension such as we have just been considering come when any great emergency presents itself. If borrowers can get all the money they want, there is no panic, but our banking reserves under the National Bank Act are so small that a general loss of five per cent of deposits precipitates a panic. This has brought our banking system into what may properly be called a chronic panic.

During the past fourteen years we have had a succession of panics, each one caused by a special difficulty, but they all have their explanation in the one fact that our banking system has no provision within itself for self-protection. In 1884 the failure of the Metropolitan Bank was said to have caused a panic. Not so. The panic was caused by the fact that banks under our system could only protect themselves at the expense of the public. The withdrawing of banking facilities when most needed was the cause of the panic. That was true also in 1893, when the silver scare took place, as is so strongly and truly stated in Mr. Parsons's letter, and in 1895, when the Venezuela message was issued. These were occasions which revealed the weakness of our system. The irritating causes come in many different ways, but the defect in the system is always the same.

What will be the effect of a declaration of war with Spain? We cannot tell, but this we know, that under our system a general withdrawal for hoarding purposes of five per cent of banking deposits all over the country would leave the banks unable to discount or to sustain credit, or to prevent a panic. We are under the shadow of that danger all the time.

THE REMEDY IS SIMPLE

We can talk about it freely because the remedy is so simple. All that is needed is to incorporate our clearing houses under a federal law, and give

to at least one in each State the power to receive from its bank members bank assets, and issue thereon at seventy-five per cent of their ascertained value circulating notes, good at any clearing house in the land. Then all danger of panic is removed.

France with her 38,500,000 inhabitants has a reserve in the Bank of France of \$600,000,000, in addition to reserves held by other French banks. Germany has given to a few of her banks a reserve power to issue currency without limit, which is practically a reserve of one hundred per cent of banking obligations. These enormous reserves preserve those countries free from panic. We are on the verge of war with Spain, and our national banks hold less than twenty per cent of their obligations in lawful money, and the percentage of all banks, national, state and private, is still less.

AMPLE AVAILABLE RESERVE REQUIRED

This is totally inadequate to protect and support commercial and banking credit in the United States, as we know by our numerous panics in late years. An ample available reserve in the form of a legal power to issue a bank currency of undoubted credit, secured by collateral in the hands of trustees, to the par of the capital of the commercial banks of the country, which would be from \$600,000,000 to \$1,000,000,000, is needed to place our banking system on a sure foundation.

This is the one war measure which transcends in importance all other preparations for the na-

tional defense, because it protects and sustains commercial and banking credit and with it the welfare of every man, woman, and child in our country.

TWO BANKING SYSTEMS

You have before you the two banking systems. One is the competitive, restrictive, liquidating, panic-producing system, which has resulted year after year in spasms of apprehension which too often have produced commercial death to our business men. The other is the coöperative, protective, sustaining system of an ample, available banking reserve, which produces stability and will protect us from panics.

The banking system of France was adopted in the stress of the revolution of 1848, and for fifty years it has maintained an unbroken record for solvency and strength. It was a war measure, and strength to resist assaults upon credit was the chief object. An emergency is needed to show us in the United States what is required to make our banking system equally strong with that of France. An earthen embankment is the simplest thing in nature, but it makes a fortress which no cannonading can throw down. So an ample, available reserve is the simplest thing in banking and the easiest to construct by law, but it gives to a banking system a solidity and stability which no panic can overthrow.

TWO BANKING BILLS

Gentlemen, you have before you two bills, representing the two systems of banking. Will you advocate that which is chiefly for the benefit of the banks, or that which will benefit all the people of our land? Will you join the theorists who have an untried scheme they wish to experiment with, or will you act as patriots, and in the light of experience advocate a law which shall protect the commercial and banking credit of the United States against internal dangers, and so make the nation able to meet and overcome all foreign foes?

During the reading of the foregoing paper, the following took place:—

Mr. COX. When you speak of 1,070,000 people engaged in business, do you include the farmers of the country?

Mr. GILMAN. No, sir.

The CHAIRMAN. You spoke of different panics. Cannot you give us the dates of those different panics?

Mr. GILMAN. Yes, sir.

Mr. FOWLER. In regard to the Metropolitan Bank, is it not a fact that they had the arrangements all made for carrying over that bank by taking its assets, and that there was only one man that prevented it? In your judgment, if that had been done, would we have had that panic?

Mr. GILMAN. I would have to refresh my memory —

MR. FOWLER. That is the fact, Mr. Gilman, that one man prevented their taking —

THE CHAIRMAN. Who was the man?

MR. GILMAN. I think the panic was on us at that time. It was caused by the operations of the bank as well as by its failure.

MR. FOWLER. These men were together, and one of the men refused to take these assets; they had to carry the bank through. Now, if they had done that — I have been told that by one of the men that was on the committee — do you think we would have had that panic?

MR. GILMAN. The occasion would have been removed.

MR. FOWLER. Your statement in that respect, in view of the facts in the case, would hardly be correct, would it?

MR. GILMAN. I think it corresponds exactly with my statement. The difficulty was in the banking system and not in the occasion. Every time a panic takes place it is a revelation of the defect in the system, and that may arise from a number of causes.

MR. FOWLER. This was a revelation of the speculation of the president, that caused the withdrawal of banking facilities.

THE CHAIRMAN. Do you mean to say the banking conditions are a fruitful source, or rather the soil in which that seed was planted?

MR. GILMAN. Yes, sir; that is what I have said. That was true also in 1893, when the silver scare took place.

(Mr. Gilman completed the reading of his paper.)

The CHAIRMAN. There are a few questions that I would like to ask. How would you constitute the capital of this clearing house?

Mr. GILMAN. The clearing houses do not require any capital. They have a financial responsibility equal to all the capital and surplus of all their members.

The CHAIRMAN. They would be made up of the banks — the banking?

Mr. SPALDING. No, the assets.

The CHAIRMAN (continuing). Would constitute the capital, and then you would allow them to use currency instead of the bank. Then currency would freely issue and they would loan this currency to the banks or simply furnish it to them?

Mr. GILMAN. Each clearing house would have the power under this bill to fix the rates of interest which the borrowing bank should pay. The profit on the loans would be for the benefit of all the members of the clearing house.

The CHAIRMAN. After one or two questions, I suppose Mr. McCleary would have the right to ask questions, and I will yield the floor to him now.

Mr. HILL. I would like to ask a question as to the understanding of a single point. Do you propose to substitute clearing-house currency for further issues of bank currency in case of necessity?

Mr. GILMAN. In case of necessity.

Mr. HILL. What provision do you make for the redemption of your clearing-house currency? It is a demand note issued in small amounts or large amounts as the clearing house sees fit. In other words, it is a direct substitute with all the qualifications and all the provisions that the bank note has?

Mr. GILMAN. Yes.

Mr. HILL. What provision do you propose to substitute for redemption —

Mr. GILMAN. The redemption is made by the bank as it would pay a check. It is not a substitute for redemption, it is the most direct and summary form of redemption.

Mr. HILL. I understand it is now payable back to the bank which issues it, and it returns it with the certificate issued to it. On the other hand, the bank could not present it to the clearing house of issue and have it paid. It must come back through the source in which it went out. You propose to issue it to a third party and they can present it direct for payment?

Mr. GILMAN. Yes.

Mr. HILL. Now, what provision is made for the general clearing houses redeeming them? They have no cash on hand and never have had.

Mr. GILMAN. A clearing house is a place where the solvency of banks, corporations, firms, and individuals is brought to a daily test. This is done by offsetting debits and credits and paying

debit balances in cash. No surer method of redeeming bank notes can be found than to require their payment through clearing houses. These notes are receivable at any clearing house in settlement of balances, and would be received by any bank in payment of any debt or liability to it. They are like bank checks. They are forwarded by the banks for collection to the banking associations, from one to another, just as they send checks for collection now, and in that way the amount is kept down to the lowest point of needs of the business community. But, on the other hand, if the bank that has made a loan wishes to take up that loan, it can deposit any form of legal-tender or clearing-house notes, no matter by whom issued —

Mr. HILL. But in the interim, while they do not wish to take it up, it is still redeemable at the clearing house.

Mr. GILMAN. Yes ; it must be received at the clearing house and redeemed by the bank.

Mr. HILL. It is only redeemed by the bank —

Mr. GILMAN. As well as by the clearing house.

Mr. HILL. Exactly ; that is what I supposed. But what provision has the clearing house to redeem it, with no money on hand ?

Mr. GILMAN. The same as any check. Checks are paid at all clearing houses to the amount of \$50,000,000,000 per annum. The collection would give the banks no trouble, because they would simply forward the notes for collection to the

bank, and the payment would have to be made. Payment is required — cash payment.

Mr. FOWLER. I understand Mr. Hill's question was, How do they pay it? They do not pay it at all. They act as agents to forward it for collection.

Mr. GILMAN. They put it to the credit of the depositor ; that is payment. They pay it out or send it on for collection, as they choose.

Mr. HILL. They issue a certificate of credit to a bank, and that certificate of credit performs the function of a bank bill. Now, then, suppose the bank has taken it out against time securities. Then, of course, they have to be responsible, as they would for the payment of their own bank notes. But where is the power of the clearing house in the mean time?

The CHAIRMAN. What Mr. Hill desires to know is what you mean when you say "the party" will redeem it. What party? Where, who, how?

Mr. GILMAN. The operation is a very simple one, indeed. The bank which wishes to take out clearing-house currency would apply to the clearing house and deposit securities, and if the securities were approved by the loan committee, the clearing house would issue its notes to the bank at 75 per cent of the appraised value of the securities. The bank would then use the notes for the payment of depositors or any purpose in the ordinary course of their business. Those bills might come on to New York, and if they were sent to us,

for instance, we might pay them out or deposit them in our bank. Our bank, if it had an accumulation of those notes more than it could use to advantage, would sort them out —

The CHAIRMAN. When you say “more than they could use to advantage,” what do you mean ; do you mean pay them out ?

Mr. GILMAN. Yes ; more than they can pay out in the ordinary course of their daily operations — they would sort out those notes and forward them to the different centres of collection.

Mr. HILL. Clearing houses —

Mr. GILMAN. Or to their correspondents for collection, the same as any draft. They would then be presented to the bank that had made the obligation. They would be its demand obligation.

Mr. HILL. How do they identify them ?

Mr. GILMAN. The bill provides that the notes shall state on the face to whom they are issued, and the bank whose demand obligation they are must pay them in cash that is satisfactory to the clearing house.

If \$1,000 of them are presented, the bank would send \$1,000 of gold or currency or a check or whatever would be acceptable to the clearing house that had issued them, and that must be done on the day that demand is made, for the purpose of securing absolute payment of the notes, and to keep them at the lowest point that is needed for the demands of business.

Mr. HILL. Then it resolves itself practically

into an unlimited issue of the bank bill by the individual banks, with the guarantee of all the banks composing the clearing house, and the bank itself must provide its own redemption, and not the clearing house for the redemption of the money.

Mr. GILMAN. Yes; if you will allow me —

Mr. COX. It does not go that far by a long shot.

Mr. CAPRON. That is the point. In regard to the return of the note to the clearing house, won't you explain that?

Mr. HILL. Your illustration of France and Germany is utterly inconsistent, I think you will find, if you will examine carefully the French and German systems, because they are required to hold 33 per cent. reserve.

Mr. GILMAN. The Bank of France is entirely free, and is under no restriction, except that of prudent management, to maintain any percentage of reserve. It could pay out all its reserve to sustain the commercial credit of France if it so desired, without the violation of any law. The six banks of issue of Germany are required to maintain a reserve of $33\frac{1}{3}$ per cent. of their note issues, but they have besides an unlimited power of note issue for emergencies. The French and German systems are therefore amply protected against monetary troubles, and they have no bank panics in those countries. Our country should be protected in the same way. If you will allow me

to make another correction of Mr. Hill's remark, and that was he said the proposed issue is unlimited. It is limited to —

Mr. HILL. Seventy-five per cent. —

Mr. GILMAN. No; limited to the par of the banking capital of the bank.

Mr. HILL. The clearing-house notes are ?

Mr. GILMAN. No bank can take out more clearing-house notes than the par of its capital.

Mr. HILL. Then it is really double — that is, in addition to their own bank issues ?

Mr. GILMAN. Yes.

Mr. FOWLER. Do I understand that the clearing house as an organization is responsible for a single cent of the obligations issued by any bank ?

Mr. GILMAN. The clearing houses are responsible, and they hold securities to protect themselves against all loss, which have been approved by their loan committee. The clearing houses would also make a profit on the loans which would compensate them for the risk.

Mr. FOWLER. No. Suppose the bank fails and the notes are perfectly worthless; who pays the notes that that bank has issued — those clearing-house certificates ?

Mr. GILMAN. The clearing houses, in the first place, from the proceeds of the sale of the collateral securities in their hands. If there is any deficiency, it is assessed upon the members of that clearing house.

Mr. FOWLER. And a provision is made for an

assessment; in other words, a mutual guarantee system?

Mr. GILMAN. So it is distributed as it was —

The CHAIRMAN. Current redemption of the bank, final redemption of the clearing house. Mr. McCleary has the floor.

At this point the committee adjourned until Saturday, April 16, 1898, at 10.30 o'clock A. M.

Saturday, April 16, 1898.

The committee met at 10.30 A. M., Hon. Joseph H. Walker in the chair.

Present: Messrs. Walker, Fowler, Spalding, Prince, Newlands, and Ermentrout.

The CHAIRMAN. Mr. Gilman, if you want to add anything to your statement of the other day, we will begin there.

Mr. GILMAN. I wish to begin with an historical note.

After the Revolution the process began of changing our laws and customs to bring them into harmony with the principles of the Declaration of Independence. Our banking system was based on the English model, and all the banks of the United States were, like the Bank of England, organized under special charters.

The Bank of the United States was the most conspicuous example of this system, and General Jackson overthrew it "to preserve the morals of the people and the purity of the elective fran-

chise." The free or general banking law of the State of New York was then enacted, April 18, 1838, and was called a second declaration of independence. Banking in the United States on republican principles dates from that time. Its two features were a general law and a secured currency. Those principles have been maintained until the present time, and are now the basis of the National Bank Act. Bill H. R. 9279 does not depart from these principles, and the only changes it proposes are to substitute the clearing house, incorporated under federal law, in place of an officer of the government as trustee for the public to hold the collateral to the circulating notes, and bank assets as the security instead of government bonds.

I would like to emphasize the point that the interests of the people are separate from and antagonistic to the interests of the banks under a banking system with an unsecured currency and a reserve of a certain percentage of obligations, provided there is no means of increasing reserves except by compelling liquidations by the borrowing public.

Out of many authorities on the subject I will read from S. Hooper's book entitled "Currency and Money."

The CHAIRMAN. Samuel Hooper, of Boston?

Mr. GILMAN. Yes; he writes as "a merchant of Boston," and once was a member of the House of Representatives. He says:—

Whenever the demand for specie has become so urgent that it is difficult to meet it, the banks that have issued the paper money become alarmed for their ability to pay specie. Then commences the remedy for the depreciation of such a currency. When the demand for specie has become so intense or the quantity of it so much diminished as to alarm the banks, the remedy commences. It is a sure though a sharp remedy. It is brought into operation by stopping all discounts at the banks and requiring the payment of all previous loans as they fall due. Traders and merchants are forced at such times to make great efforts to obtain money to pay back their loans to the banks. To do this they must sell property at low prices or borrow money at exorbitant rates. This is the only process by which to remedy the depreciation of a mixed currency consisting partly of paper money redeemable on demand in specie. It is a process which invigorates the currency at the expense of the industry and the enterprise of the country.

And hear what Hon. Nathan Appleton, of Boston, said, as quoted by Mr. Hooper : —

But these alternations of bank expansions and nominal prosperity followed by bank contraction, disappointments, and perhaps failures, are very much to be deprecated. The banks, to be sure, have no difficulty in these cases if well managed ; the whole pressure is thrown on the mercantile community.

The CHAIRMAN. The whole pressure of what?

Mr. GILMAN. Of a bank crisis ; of a panic. The banks do not suffer ; the whole pressure of the panic is thrown on the mercantile community. Mr. Hooper continues : —

If paper money is ever useful to a country it can only be in great emergencies, and it should be reserved as a resource to supply the means for the defense of the country when other resources are exhausted. At such a time it may be used for the business transactions within the country to relieve the coin from that service so that it may be used by the government in the exigency for the common welfare.

Now, that is exactly what I said, and I did not know that Mr. Hooper had said it.

No blame should be imputed to the banks or to their directors for the inconvenience and distress caused by forced liquidation. They have consulted only the interests of the banks. In doing so they were true to the system.

Mr. FOWLER. Read that again.

Mr. GILMAN (reading). "In doing so they were true to the system." That is, when they carry out the system according to its legal provisions.

Mr. FOWLER. It means more than that. It means they were true to the principle of banking.

Mr. GILMAN. If you will allow me to finish this I think you will see he refers to the system of banking then prevailing.

Mr. FOWLER. I know ; but he refers not to the system of banking in any given time in the world's history, but to every relation which banking bears to commerce.

Mr. GILMAN. No ; he refers to banking under this particular peculiar system.

Mr. FOWLER. What system?

Mr. GILMAN. This system of a large number of banks issuing currency and holding the security themselves, which creates lack of confidence.

The CHAIRMAN. Each independent bank?

Mr. GILMAN. Each holding security in its possession and issuing its own notes. When a lack of confidence strikes the country, and these notes are sent home and the banks will not take them from their customers, and some banks fail and banking facilities are withdrawn, and their customers are compelled to liquidate and forced to sell out at great loss, then the panic which results from this state of affairs is due to the system —

The CHAIRMAN. You mean due to the system that protects them?

Mr. GILMAN. I am just quoting his words —

The interest of the bank is at variance with the public interest. The customers of the bank sustain the loss while the banks have had the profit —

The CHAIRMAN. Who says that?

Mr. GILMAN. That is what Hooper says. Then he goes on —

The CHAIRMAN. Let us have that.

Mr. GILMAN. And says that he advocates as a first step to reform —

That all banking should be under a general banking law, and secondly, that banks should be required to place security for their currency in the hands of a trustee.

These are the two points behind the national banking law —

Mr. FOWLER. I beg your pardon ; you are mistaken. All the banks of the South and those following the New York guarantee system, where they put up the securities themselves, put up state securities and every kind of security, and the result was that they broke down completely. They absolutely destroyed the banks, and right by the side of it and succeeding it the system of issuing notes by the banks of the South went on, and through all these crises stood and sustained themselves and did not fail.

The CHAIRMAN. That is a matter which is absolutely incontrovertible. All statistics prove that fact.

Mr. NEWLANDS. Then Hooper is wrong.

Mr. FOWLER. If you will allow me, the possible defense of the proposition is this, the distinction is this, rather, that what you propose to put up is current liquidated wealth ; that is the only defense you have and that is your defense. In your case they put up the current liquidated wealth of the country, while under the system of New York and the one he refers to they put up the time obligations of the State, mercantile, etc. ; and there are a great many men in the country to-day who, if they exhausted our government bonds, would put up railroad bonds, school bonds, and every other sort of thing, and the whole thing has been accepted historically in every part of the world, and more particularly in this part of the country.

Mr. GILMAN. There have never been any losses on the clearing-house certificates ; never have been, and never can be.

There have never been any losses on national bank notes secured by government bonds, and never can be. These are the two most recent instances of bank currency secured by assets in the hands of a trustee. The losses referred to by Mr. Fowler were due to defective security and not to the principle of a trustee or secured currency. Many railroad bonds have become worthless, but no one advocates on that account to abandon the idea of having a trustee under the mortgage. A trusteeship is a necessity where the ownership of the obligations is participated in by many different persons. The Georgia law of 1838, if I remember correctly, allowed slaves to be used as collateral to bank notes. The limitation to specific classes of collateral is wrong in principle. The banks should be allowed to pledge their assets, and the trustee — that is, the clearing house or their loan committee acting for them — should determine as to the sufficiency of the collateral. Experience shows that by this method, on account of their contingent liability, the clearing houses will exercise great prudence to protect themselves from loss, and in so doing they protect the public also.

The CHAIRMAN. Let me ask you a few questions. How would the capital of the clearing houses be furnished ?

Mr. GILMAN. The clearing house is only the

representative of the associated banks. There is no separate capital, but a clearing house has the responsibility of all the capital of its bank members. Clearing houses are trustees in this bill.

The CHAIRMAN. Trustees of nothing?

Mr. GILMAN. To hold absolute security —

The CHAIRMAN. That brings us right to the point. What is the absolute security they are to hold?

Mr. GILMAN. They are to hold such assets as the banks offer them, and which the loaning committee approve as good.

The CHAIRMAN. Just give us a list of the assets.

Mr. GILMAN. The list of the assets would be commercial assets, promissory notes, bills of exchange, convertible bonds and stocks, and other securities and evidences of debt. These assets are to be received as collateral security for the circulating notes of the said association.

Mr. SPALDING. To the extent of 75 per cent.?

Mr. GILMAN. The notes are to be issued at 75 per cent. of the appraised value of the assets.

The CHAIRMAN. Now, the idea of Mr. Appleton and Mr. Hooper — both of whom I knew, and I have talked over these financial matters with them — in what you have quoted, went to the point of the coin redemption of currency notes issued by banks. Now, what provision do you make for maintaining the parity between paper money and coin, and how? Their point was that that should

be maintained with more certainty and without injury to the public. What is your scheme?

Mr. GILMAN. Bill H. R. 9279 provides that security which is convertible, and which is approved as good security, is deposited with the clearing house as collateral for the loan of its circulating notes; and the collateral security provides for the ultimate payment of these outstanding notes, the notes being issued at 75 per cent. on securities supposed to be worth par, 100 cents. The coin value of those securities being 100 per cent., notes to the extent of 75 per cent. of the value are issued on them, and that is like lending 75 per cent. of the coin value.

The CHAIRMAN. That we have understood — that is all clear — but that does not meet the point at all. How is the clearing house to get the coin to redeem the notes?

Mr. GILMAN. A clearing house is a place for the mutual set-off of debits and credits. If the coin is not provided to pay the notes by the banks whose obligations they are upon the day of demand, the loan committee of the clearing house must sell those assets to provide the money to take up those notes, and they have a margin of 25 per cent. to protect them, and if that margin is not sufficient, then any loss is to be assessed upon the members of the clearing house.

Mr. FOWLER. If exceeding —

Mr. GILMAN. The securities.

Mr. FOWLER. Not only that, but they still have a claim against the bank?

Mr. GILMAN. Yes.

The CHAIRMAN. Is your answer, then, that the coin to redeem these notes and all responsibility for their redemption is to be universal, as it was under the Suffolk system in New England, on the banks, and the clearing house is to be absolved from that?

Mr. GILMAN. The clearing house represents all its bank members. The bank borrowing money of the clearing house is the first guarantor, and if a loss occurs on a loan it is assessed on the other members.

I do not think the Suffolk system is parallel. The Suffolk Bank was the redeeming agent for banks of New England, each providing its own redemption fund. I do not think there was any mutual responsibility under that system. The Suffolk Bank system does not provide a currency which circulates in the community, but one which gravitates in a straight line for the redemption bank. It is a question whether it does not make money scarce in the country and plenty in financial centres.

The CHAIRMAN. I mean, absolved from that obligation?

Mr. GILMAN. No. The clearing house is acting simply as trustee for the public to hold these securities, and if the debt is not paid on demand, the loan committee then administers those securities and they provide the money by their sale. If there is a loss which the borrowing bank cannot

pay, it is assessed on the other members of the clearing house.

The CHAIRMAN. When you say a "debt," you mean when the currency is presented and it is not redeemed they have to sell these securities?

Mr. GILMAN. When any of the currency which has been issued to the bank is not paid upon demand by that bank, that makes the loan immediately due, and the clearing house, as trustee, would immediately proceed to market those securities and close out the loan, and would have then a claim against the bank for any deficiency, and if the bank was insolvent the deficiency would be assessed upon —

The CHAIRMAN. What do you mean by closing out these securities?

Mr. GILMAN. Selling them for coin or legal tender.

The CHAIRMAN. You mean to say the clearing house would sell those securities to-day for gold and redeem these currency notes that they have issued and loaned to the bank in the gold that they got from the sale of these securities?

Mr. GILMAN. Yes; in the gold or other legal tender.

Mr. PRINCE. Now, to make it plain to me, suppose I have a twenty-dollar bill issued by the First National Bank, say, of Galesburg, Ill., under your proposed bill. I present that twenty-dollar bill to the bank and it refuses to pay. I ask for the gold and they refuse to pay it. Do I understand you

to say that thereupon the clearing-house association proceeds to dispose of the assets or securities placed in the hands of the trustees in the clearing-house association, and that those securities are converted into coin, and out of that fund or coin I am to be paid the twenty dollars?

MR. GILMAN. No; the banks wait for the liquidation, not the public.

MR. PRINCE. How long am I to wait? Say I am a poor man, and present my twenty dollars as a result of my month's work; say I bring that to the bank, which refuses to pay me, and I want to pay my rent, and if I do not, I will be put out of my house the next day; how am I to get my money?

MR. GILMAN. Under this law the banks guarantee the payment of that money. All you have to do to get your twenty dollars is to deposit the twenty dollars to your credit, or get some friend to do it if you have not a bank account, and get the money. Then the whole process of presenting that note is handed over to your bank and they relieve the business community of the whole matter, and that note would be deposited in the clearing house in payment of the obligations of the bank to the clearing house, and whoever had that note and wanted to collect it would send it to the bank and demand payment; so that the whole thing is taken out of your hands, and you do not have to go to the issuing bank to get your money, but you simply put it in your bank and get the money.

MR. PRINCE. But I have no bank account and

I go to the bank which has issued this twenty dollars. I have worked for this money, and I go to the First National Bank, if you please, of the city of Galesburg, which has promised itself to pay this twenty dollars, and the clearing house has promised that this bank will pay it. It is issued through the clearing house by this First National Bank of Galesburg under your bill. I present the bill to that bank and that bank refuses to pay the bill. It is insolvent; it has collapsed and gone. Shall I wait around the corner somewhere until something is done?

Mr. GILMAN. Say you went to the bank and found a notice on the door, "This bank is closed and in the hands of a receiver." Your note would be guaranteed by the remaining banks of the clearing house and its goodness would be unquestioned and no one would think of refusing to take it at par.

Mr. PRINCE. Is it legal tender?

Mr. GILMAN. It is not legal tender.

Mr. PRINCE. But suppose the man refuses to take it; suppose a man does not want to take it?

Mr. GILMAN. Then you could put it in another bank. It is supposed that anybody who has a small bill to pay can find a friend who has a bank account himself and get him to deposit that, and the bank assumes the collection of the note and the twenty dollars is put to his credit and he can draw it out and give you the gold immediately on the day he put it in the bank; any holder could

get the gold or the legal tenders for the bill of that broken bank immediately, in spite of the failure. The banks would attend to the whole matter.

MR. PRINCE. Let me get it a little plainer.

MR. SPALDING. Put the reverse of the proposition — how would you collect your bill?

MR. PRINCE. I can explain that later on when the time comes. I have this bill of twenty dollars, and I owe Mr. Fowler rent for the house in which I live. He has sued upon that for forcible entry and detainer to get me out. He wants me out, and if I tender him the twenty dollars I owe him, which is the amount of rent and all costs up to date, say it just covers twenty dollars, I take twenty dollars of that kind of money issued through the clearing house to this bank and the bank does not pay me. I stop by Mr. Fowler and I say, "Here it is," and he says, "It is not legal tender, and if not legal tender I will not accept it." And I tender it to the court and the court refuses to accept it.

I then look around, and I have no bank account, and I have no friends; I am without a friend on earth, and I have a family, and I am liable to be turned out of my home. What shall I do? Where shall I go to get the money to pay Mr. Fowler, who will not take the bill I have?

MR. GILMAN. You can go to any bank, even if you were not known to the bank. If there was any bank in the district, say ten miles off, you could go to that bank and get your money. The

profit to the banks on the currency would lead them to take care of its credit.

The CHAIRMAN. What is the provision of law in regard to that?

Mr. GILMAN. This law provides that these notes are good at the clearing house, and consequently any bank that has those notes can pay them to the clearing house in satisfaction of any debt against it, and that makes them current all over the country.

Mr. FOWLER. Will they take them without discount?

Mr. GILMAN. Without discount.

Mr. FOWLER. Take Mr. Prince's case. Suppose he went to a bank next door, and said: The First National Bank is closed which issued this note for twenty dollars; at what rate of discount, if any, would they take this twenty dollar bill?

Mr. GILMAN. They are obliged to take it at par. They can afford to pay par because it is good in the clearing house.

Mr. FOWLER. They are not compelled to take it?

Mr. GILMAN. Section 13, line 8, of the bill 9279 provides that the circulating notes "shall be received at par at all the clearing houses in the United States organized under this act," and in section 12, line 17, it provides that "payment is guaranteed by the associated banks of the United States through any clearing house." I suppose no other party can be compelled to take a note that is not legal tender.

Mr. FOWLER. Oh, yes, they can ; national bank notes are not legal tenders, and banks are compelled to take those.

Mr. GILMAN. National banks are not compelled to give legal tenders or gold for national bank notes issued by other national banks. Mr. Prince would be in the same fix with his twenty-dollar national bank note as if it were clearing-house currency. A national bank is only compelled to take it "for any debt or liability to it." So his landlord could refuse to accept a national bank note, and national banks could refuse to give him gold or legal tender for it, and he would have to call in a friend, just as I have suggested. As a matter of fact, national bank notes and clearing-house currency would both circulate without question. It is provided that these notes shall be received at any clearing house, and that makes them at par.

Mr. FOWLER. How are you going to get them there? Who is going to get them there? Suppose the man was miles away from the clearing house.

Mr. PRINCE. Suppose the clearing house was in Chicago and I am here.

Mr. GILMAN. Competition in business is so active that no difficulty is ever experienced in cashing absolutely good currency. The great object is to make the notes of undoubted goodness, and then to make them receivable by all banks, at all clearing houses over the land, for all debts due to banks. These guarantees would make the notes pass from hand to hand without difficulty. If a

bank has an accumulation of these notes on hand it would immediately send them to the issuer — to the bank.

Mr. FOWLER. Suppose they receive this twenty dollars of Mr. Prince and they did not know what their assets were worth over there, and he says he will not give but fifteen dollars, what protection has Mr. Prince got?

Mr. GILMAN. The failure of the bank makes no difference in the goodness of the note. It is guaranteed by all banks. By this process of compelling the banks to accept these notes in payment of their credits at the clearing house it throws upon the banks the burden of collection. That is the point.

Mr. FOWLER. Do you not know that a bank always takes advantage of every piece of paper put to them? They will say, "I do not know anything about this thing." The cashier will say he will not take this because he does not know about it or he will not give more than fifteen dollars for it.

Mr. PRINCE. And I owe you twenty dollars.

Mr. FOWLER. Would he not be unfortunate in that position? That is the point, I understand.

Mr. NEWLANDS. That could be entirely met by making it legal tender to the banks.

Mr. GILMAN. That is accomplished by compelling the banks to accept these through the clearing house.

The CHAIRMAN. Where does the bill compel them to accept directly? What is the provision?

Mr. GILMAN. I read from the bill.

The CHAIRMAN. What is the section?

Mr. GILMAN. Section 9; if you will, please turn to section 9.

Mr. NEWLANDS. What bill is this?

Mr. GILMAN. This is H. R. 9279. The seventh line on the ninth page: —

The bank member taking said circulating notes shall engage to redeem them at all times when called upon to do so by the clearing house issuing the notes and to give any additional collateral needed to restore any depreciation, etc.

Now, look at section 10.

That each bank member taking such circulating notes —

The CHAIRMAN. You want to talk right on this point. In line 7, page 9, it says this: —

The bank member —

That is, the bank member of the clearing house, I suppose —

Taking said circulating notes shall engage to redeem at all times when called upon to do so by the clearing house issuing the notes.

Now, there is nothing giving a person any right to call for the redemption of those notes at the bank except the clearing house which issues them.

Mr. PRINCE. I suggest this, that the bank members shall be required to redeem at all times said circulating notes when called upon so to do.

Mr. FOWLER. Then you make each bank re-

deem the notes of all banks. How are you going to fix it then ?

MR. PRINCE. The bank I ask to pay the note refuses to pay it. Then I go, as Mr. Fowler says, next door and it refuses to take it without a discount. Have you any provision in this bill that, say, the Second National Bank, which is in the building next door engaged in the banking business, will have to take my note at par? That is the point I want to get at and to clear up. This provision does not seem to me to require it.

MR. GILMAN. Nor does the National Bank Act contain that requirement in that form. The demand is made by the clearing house, because the notes would actually come into the hands of the clearing house. I can see that your suggestion would be an improvement to the bill, and make it more clear on that point. This provision in reference to the clearing house covers the whole country, and any person in any city anywhere having a note can deposit it in the bank, and every bank in the clearing house is compelled to accept it in settlement of the claims due that bank. Thus, the collection of the note falls upon the person who receives it.

MR. FOWLER. That would be the depositor ?

MR. GILMAN. The depositor puts it in his bank, which pays it to the clearing house ; and by making the clearing house accept it in payment of balances with all the banks in the clearing house, that puts the notes at par.

Mr. NEWLANDS. As I understand your bill, every bank member is compelled to make redemption of its notes it takes from the clearing house, and you say that every other bank member would be willing to accept those other notes issued by another bank member because he could tender them to the clearing house in settlement of claims due the clearing house from him?

Mr. GILMAN. Yes.

Mr. NEWLANDS. Now, that is the inducement, but there is nothing in your law which would compel the other bank member to take the notes of another bank and give par value for them. You simply say the inducement is that he can make use of those notes in settling the claims of the clearing house against him?

Mr. GILMAN. Yes. The case would be exactly the same as now exists with national bank notes.

Mr. NEWLANDS. You are aware that under the National Bank Act any holder of any national bank note issued by any bank can compel a bank other than the one issuing it to take that note in payment of the obligation due from him to the bank?

Mr. GILMAN. That ought to be included in this bill if it is not here. That point ought to be covered, as there is absolute security, and it is no hardship upon the banks to compel them to accept these notes from the public as well as through clearing houses. That provision is in the National Bank Act, was in the old state bank laws, and is

contained in the present German banking law of March, 1875.

The following sentence should be added at the end of section 13, page 14, line 14: —

And every bank member of every clearing house organized under this act shall take and receive at par, for any debt or liability to it, any and all notes or bills issued by any clearing house of issue organized under this act.

I would also add immediately after the above the following paragraph: —

The meeting together of any persons who are officers, agents, or employees of persons, firms, or corporations in any one or more places once in thirty days or oftener for the purpose of exchanging, paying, or in any other way satisfying any obligations used in commerce among the several States by any two or more of such persons, firms, or corporations, or for the purpose of the settlement of money transactions by the mutual set-off of debits and credits, commonly called "making clearances" for banks, shall constitute such persons, firms, or corporations represented in such meeting a clearing-house association for the purpose of the taxation herein imposed, and such persons, firms, or corporations represented shall be jointly and severally liable to pay, and shall pay, into the Treasury of the United States a duty in amount equal to one fiftieth of one per centum on the aggregate amount of all such obligations exchanged, paid, or in any way satisfied, or on the aggregate amount of the money transactions settled by the mutual set-off of debits and credits, at each and every meeting of persons acting for such persons, firms, or corporations: *Provided, however,* That in case any such clear-

ing-house association pays one half of the tax herein imposed on or before the day it is due and payable, the other half shall be, and is hereby, remitted : *And provided further*, That the tax herein imposed on clearing-house associations herein described shall be wholly remitted to all members of clearing houses that are incorporated under this act.

I would also add in section 9, page 9, line 8, to make it read as follows, beginning with line 7 : —

The bank member taking said circulating notes shall engage to redeem them in the lawful money of the United States at all times upon demand of payment duly made during the usual hours of business at the office of such bank member, and also when called upon to do so by the clearing house issuing the notes, etc.

Mr. NEWLANDS. Does your bill make any provision as to the kind of coin every bank shall keep on hand for the redemption of the circulating notes issued to it by the clearing house?

Mr. GILMAN. No.

Mr. NEWLANDS. That is left to its own determination and discretion?

Mr. GILMAN. Yes; because the present bank law has complete provisions as to reserves, and it is best to leave that law just as it is. When the clearing-house currency is secured by gold values, and in addition to that, when you add 25 per cent. of those values to its security, and also add the guarantee of all the banks in the country, a bank circulation of this description could take care of itself.

Mr. NEWLANDS. Would you expect the bank to keep any funds on hand for that purpose?

Mr. GILMAN. Not for the purpose of providing for notes in addition to its other coin reserve; no.

Mr. NEWLANDS. What do you regard as a safe reserve for a bank to keep against the calls of its depositors?

Mr. GILMAN. I think that the percentages of reserves that should be kept by banks depend upon the system under which the bank is operated. Now the reserves under our national system are entirely inadequate, because there is no provision for self-preservation, and a diminution of those reserves about 6 per cent. all over the country for hoarding purposes would cause a panic. But take the Credit Lyonnaise as an example. The Credit Lyonnaise is under the French system, and its advertisements may be seen in the New York papers and elsewhere, giving a statement of its condition.

It is an immense bank, and it has only about 10 per cent. of its obligations on hand in cash. That is according to a calculation I once made. It has 10 per cent. more in call loans, and then it has bills receivable which it advertises are "immediately discountable at the Bank of France" to the extent of 50 per cent. of its obligations, and adding these reserves together you have 70 per cent. of the obligations of the bank, which are under their immediate call, and that makes a strong and impregnable position. It is strong with only 10 per cent.

in gold on hand ; but 10 per cent. is sufficient under such a system.

Mr. FOWLER. Under the Credit Lyonnaise system ?

Mr. GILMAN. Under the system prevailing in France where the Credit Lyonnaise has its head office.

The CHAIRMAN. That is to say, it is one of the branch banks —

Mr. GILMAN. No, it is not.

Mr. NEWLANDS. He says, in effect, the Bank of France has branches ?

Mr. GILMAN. The Bank of France supports the whole banking system of France with its reserve of \$600,000,000 in gold and silver —

Mr. NEWLANDS. As against what amount of deposits ?

Mr. GILMAN. I should say that is about 60 per cent. of its obligations. It is 85 per cent., I think, of their note circulation, and 60 per cent. or 65 per cent. of the entire obligations, including their deposits.

Mr. NEWLANDS. You say the amount of reserve depends upon the system ; that under the national banking system of this country the reserves are inadequate. What reserves do you understand are kept as a rule by national banks in this country ?

Mr. GILMAN. The reserves kept by the national banks vary in different parts of the country. There is a legal requirement of reserve to be held in lawful money. The country banks are required

to hold 6 per cent. of their deposits in lawful money in their vaults. Banks in reserve cities of the second class are required to reserve $12\frac{1}{2}$ per cent., and banks in central reserve cities 25 per cent. The Western banks, the outlying banks, beyond the reach of our money centres, hold the largest amount of cash reserve. In Colorado, Nevada, California, and Oregon the percentage of reserve held to deposits, according to the comptroller's report of October 6, 1896, was 29.2 per cent.; the amount held above requirements was therefore 23.2 per cent.

In the Eastern States of Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut the country banks held 10.7 per cent. at that time, having a surplus of only 4.7 per cent. above the legal requirements, and yet they held \$162,000,000 of deposits against \$43,000,000 of deposits of the four first-named States, and the other States of the Union are classified between those two extremes. The average of the surplus reserves of the total banks in the United States above the legal requirements was 6.6 per cent. at the time named.

Mr. NEWLANDS. When you say that the reserves of the national banks are inadequate, do you mean the legal reserve or the actual reserves that they have?

Mr. GILMAN. I refer in this to the lawful money reserve.

Mr. SPALDING. Kept in the safe?

Mr. GILMAN. Kept in the safe.

Mr. NEWLANDS. Do you refer to the amount required by law, or the amount that they actually keep on hand, if the amount actually kept on hand is in excess of the legal requirement, as inadequate?

Mr. GILMAN. Both are inadequate.

Mr. NEWLANDS. I understand you to say a withdrawal of 6 per cent. of the reserves of banks for hoarding —

The CHAIRMAN. Deposits, you mean?

Mr. GILMAN. Six per cent of deposits.

Mr. NEWLANDS (continuing). Would cause a panic?

Mr. GILMAN. I would rather put it in this way: It would put the banks in a position where they would not be able to discount or afford relief to the business community, and they would be obliged to stop discounting and to call in loans to repair their reserves.

Mr. NEWLANDS. About what are the total deposits in the banks of this country according to your understanding?

The CHAIRMAN. Those are all matters of statistics.

Mr. NEWLANDS. I know.

Mr. GILMAN. I should say, according to the report of the comptroller of the currency —

The CHAIRMAN. What date?

Mr. GILMAN. October 6, 1896. There are 8208 commercial banks, including national,

state, and private banks, which had deposits of \$2,553,000,000.

Mr. NEWLANDS. Those are national banks?

Mr. GILMAN. National, state, and private banks. There are loan and trust companies and savings banks in addition to that, making 9456 as a total number of banks reporting, having at that time \$5,075,000,000 of deposits.

Mr. NEWLANDS. Now, leaving out of view savings banks and stating it in round numbers, it would be about \$4,000,000,000?

Mr. GILMAN. The commercial banks, which are the ones we ought to specially regard, have \$2,553,000,000 of deposits.

Mr. NEWLANDS. Then 6 per cent. of that would be \$150,000,000, would it not?

Mr. GILMAN. One hundred and fifty million dollars.

Mr. NEWLANDS. A withdrawal of \$150,000,000 of deposits from the banks would create this condition approaching a panic?

Mr. GILMAN. Under the strain of distress, not under the ordinary operations of business. There is a distinction.

Mr. NEWLANDS. If they are withdrawn for the purpose of hoarding, do you not think a panic would be produced by the withdrawal — you make the distinction, I believe, between the withdrawal of deposits and redemption of the cash reserve of banks, do you not?

Mr. GILMAN. Yes. A closing of accounts may

reduce deposits by what is equivalent to journal entries, without payment of cash.

Mr. NEWLANDS. How much would a reduction of \$150,000,000 in deposits indicate a reduction in the cash reserve of banks?

Mr. GILMAN. About 6 per cent. of deposits, but 33 per cent. of the total reserves.

Mr. NEWLANDS. If the deposits were reduced \$150,000,000 in all the banks of the country, what amount of coin reserves would that mean was withdrawn from the banks or lawful money reserves?

Mr. GILMAN. That would be determined by the nature of the withdrawal. If there were simple cross entries by which certain accounts were closed out on one side and certain other accounts were closed out on the other, it might not require any transfer of money particularly; but if that reduction was caused by the demand of interior banks to strengthen their reserves or a demand arising from merchants who desired to put away money in their safe-deposit vaults for the purpose of providing against any contingencies, it would be an entirely different matter, and 6 per cent. of deposits withdrawn in this way would be sufficient to throw the whole system out of gear, for it would be equal to the withdrawal of one third of the reserves.

Mr. SPALDING. New York went through something like that about two months ago.

Mr. NEWLANDS. Do you not think there ought

to be some provision requiring a larger reserve to be kept by banks?

MR. GILMAN. I think that is the great want of the country at the present time, and that a reserve can be provided either by the power to issue a credit currency as in the case of the German banks, which does not cost anything, — it is nothing but the legal power, — or it can be provided by the actual putting up the money. A reserve provided in either way affords ample protection to the credit system.

THE CHAIRMAN. Can you furnish me, and if so, will you do so, the items of the assets and liabilities of the Bank of France anywhere within three or four months after the occupation of Paris by the Germans?

MR. GILMAN. I will endeavor to do that.

[Subsequently Mr. Gilman furnished the following statement concerning the Bank of France.]

As requested, I now give you a statement of the assets and liabilities of the Bank of France under three dates, June 30, 1870, September 8, 1870, which was the last rendered under the Empire, and June 29, 1871, which was the first rendered under the Republic. Also to assist in understanding same, I give the valuable comments thereon of the (London) "Economist" in their issue of July 8, 1871.

Bank of France Accounts

	June 30, 1870.	Sept. 8, 1870.	June 29, 1871.
LIABILITIES.			
Capital	£7,300,000	£7,300,000	£7,300,000
Profits and reserve . .	1,326,000	1,326,000	1,334,000
Notes in circulation and drafts on provinces. .	59,588,000	73,193,000	89,985,000
Public deposits	7,031,000	7,151,000	5,631,000
Private deposits	17,864,000	18,820,000	22,246,000
Reserve for liquidation of three branches . .	. . . . .	. . . . .	1,040,000
Total	93,109,000	107,790,000	127,536,000
ASSETS.			
Cash and bullion	51,900,000	32,320,000	21,994,000
Private securities	30,315,000	64,250,000	21,462,000
Postponed bills . . . . .	. . . . .	. . . . .	14,855,000
Government securities . .	10,142,000	10,142,000	9,782,000
Treasury obligations . . .	. . . . .	. . . . .	47,720,000
Advances to city of Paris .	. . . . .	. . . . .	8,400,000
Property of the bank, sundries, etc.	751,000	1,078,000	3,324,000
Total	93,108,000	107,790,000	127,537,000

THE REMARKABLE ACCOUNTS OF THE BANK OF FRANCE

The accounts which the Bank of France has this week again for the first time since September begun to publish, are perhaps the most remarkable bank accounts which have appeared. They represent the effects of a greater destruction in the political elements of credit (taking the war and the civil commotion together) than have ever been known since banking became a trade, and that effect has been shown by the accounts of a bank

much larger and stronger than any which has ever before been subjected to an equal or an analogous experience.

The most important fact is that after all the calamities which have happened, even now the Bank of France cannot be said to stand at all badly, if we take due account of its peculiar position and circumstances. Of course the liabilities of a bank which has been required by its government to suspend specie payments, and which pays its outgoings in its own inconvertible paper, are for the present only nominal; they would only become real if specie payments were resumed. But if specie payments were resumed and if the liabilities of the Bank of France in consequence became real, these are what they would be: —

Notes and drafts in circulation	£89,985,000
Public deposits	5,631,000
Private deposits	22,246,000
Total	117,862,000

and the reserve would be nearly £22,000,000, or very nearly one fifth. And this is really a very large reserve for a country like France where banking is very little developed.

It is certainly a much larger proportionate reserve than exists in this country [England]. The peculiar provision of Peel's act, which separates the banking from the currency reserve, makes a comparison with any other country always difficult, since no other country has any corresponding circulation. But if we take the banking liabilities

of six joint-stock banks only, and remember that the reserves of notes and coin in the Bank of England is the only store of actual cash which England possesses to meet the banking liabilities of these banks and others, we find : —

Banking Liabilities of the Bank of England and Six London Joint-stock Banks, December 31, 1870

Bank of England :	
Public deposits	£6,286,000
Private deposits	20,283,000
Seven-day and other bills	750,000
	<hr/>
	27,319,000
London and Westminster Bank	22,869,000
London Joint Stock Bank	17,315,000
Union Bank	15,413,000
London and County Bank	16,506,000
City Bank	4,274,000
Consolidated Bank	2,496,000
	<hr/>
	106,192,000

And the reserve of notes in the banking department is £12,574,000, or 12 per cent. of the banking liabilities. Or if we include the bank-note circulation and make the Bank of England accounts up into the “old form,” as it has now for so many years been called, the account is —

Liabilities, including Circulation of Bank of England

Bank of England, circulation and deposits	£51,512,000
London and Westminster Bank	22,869,000
London Joint Stock Bank	17,315,000
Union Bank	15,413,000
London and County Bank	16,506,000
City Bank	4,274,000
Consolidated Bank	2,496,000
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Total	130,385,000

and coin and bullion in both departments is £22,383,000, or 17 per cent. of the entire liabilities, whether of banking or of circulation.

In both cases, when we include only six joint-stock banks, we find that the ratio of the English reserve to the English liabilities is less than that of the French reserve to the French liability; and the liabilities of these six banks are only an infinitesimal small part of the liabilities of England. If we could give all the liabilities of the private banks — all the liabilities of the English country bankers, whether on deposits or circulation — and all those of Irish and Scotch bankers, we should have a most formidable total. Broadly speaking, the reserve in the Bank of England is the only reserve (except the cash in the till and the comparatively small sums kept in Scotland and Ireland in conformity with the Act of 1845) which is held against it; but the French liabilities outside of the Bank of France are, in comparison, very trifling, so that we are left with the great and strange result that after the invasion and after the civil war the credit system of France rests on a larger basis of cash and is supported by a far larger percentage of reserve to liabilities than our English credit system, though the latter is in its ordinary state and has not been tested by either invasion or internal convulsion.

The principal reason of the remarkable present strength of the Bank of France is its unparalleled strength last year. At that time its liabilities were —

Notes and drafts	£59,588,000
Public deposits	7,031,000
Private deposits	17,864,000
	<hr/>
	84,483,000

and its bullion and specie nearly £52,000,000, or 62 per cent. of its liabilities. Probably never since banking has become a trade, — at least has taken its modern form of a receipt of deposits and an issue of promissory paper, — has any bank held so large a proportion of cash reserve to its current liabilities as the Bank of France last year held. Most fortunately these strange and unprecedented political calamities attacked the bank at a period of exceptional strength, and therefore it has been able to surmount them so easily and to stand so well at last.

The next most remarkable point — indeed, in one sense the most remarkable of all, for it is quite new and has never been stated before — is that the advances to the trading community of France have diminished. In September, in the last account which was published till now, the discounts had risen to £64,000,000, while they are now £36,317,000, showing a reduction of nearly half since September. Nothing can speak more conclusively for the substantial soundness, both of the business of the Bank of France and of French commerce in general, than that it should have been possible for the bank to obtain and for the community to make this immense repayment.

The immense augmentation in the paper circulation was obvious, was known before the publication of the accounts, and has therefore been much discussed. There is an important point on which it is desirable that opinions should be clear.

As yet the issue of bank notes by the Bank of France during the invasion has been like the issue of bank notes by the Bank of England in a panic and after the suspension of Peel's act. In such cases with us a great auxiliary circulation of checks is on a sudden rendered less efficient than usual, and requires at the same moment a greater support of bank notes or coin than usual. Consequently at that moment of fear an issue of bank notes can occur without depreciation. Just so in France. The metallic circulation has lately been largely hoarded, and therefore the paper circulation is needed to take its place, and has taken it without being depreciated. But soon these hoarded sums of metallic money will come forth — some are now being sent forth on account of the loan — and it is not very easy to see how, if the metallic money comes out, the paper money can remain as large as it is without falling considerably in value.

The enormous augmentation of the loan by the Bank of France to the French government was a necessity in their position. They obtained the means to make it partly by diminishing their bullion, but mainly by an augmentation of paper currency which they could not have obtained with-

out the leave of the government. And as the government gave that leave they were right to obtain the principal benefit from it.

The Bank of France is an institution entirely opposed to all English ideas. The governor and deputy governor are appointed by the state, and they are, in fact, supreme in the bank. The intervention of the executive government in banking is opposed to established opinion and to sound political economy; but this much, at least, may be said: If the state in any country begins to foster banking it should do so in such a manner as to have a perfect control over the banking which it fosters.

The French government did not, like the government of India with the old Bombay Bank, give the credit of its sanction to a bank over which it had no control. It took absolute authority over the bank, and by means of a council of skilled regents it is enabled to exercise this authority fairly. This may not be as good as a system in which deposit banking, at any rate, is open to all the world, but it is the next best substitute for it. And at the moment of this disastrous invasion it has enabled the state and the bank to coöperate and to aid one another in a singular and felicitous manner.

The CHAIRMAN. Can you give me, and will you do so, either a copy of or information as to where I can find the speech of Mr. Goschen in

January, 1890 or 1891, concerning the financial condition of the Bank of England?

Mr. GILMAN. Yes; Mr. Goschen's speech is discussed and quoted in a pamphlet written by S. F. Hopkinson, the Leeds proposal and the answer from London.

The CHAIRMAN. The securities, as you call them, that would be pledged by the bank to the clearing house for the currency that the clearing house furnishes the bank would be the ordinary securities or notes that it took in its regular way of business as a bank?

Mr. GILMAN. Yes, sir.

The CHAIRMAN. When a bank issues currency directly against its assets, as is done in France and Germany and was done under the old Suffolk system and under the old state bank system, it issues it against these very securities that under your system it issues?

Mr. GILMAN. Yes; the only difference being that in one case there is the actual pledge of the assets in the hands of a trustee to secure the clearing-house currency, and there is no such pledge when the notes are issued against the assets in their own hands. In France the privilege of note issue is given to one bank, and in Germany to about six. To give the same privilege in our country to three thousand banks would not follow their example, and would invite disaster. Currency was not issued under the Suffolk system; that was only a method of redemption.

The CHAIRMAN. Then the only difference is in the distinction and positive pledge of specific assets of a bank placed in the hands of the second party, rather than the whole assets of the banks remaining in the hands of the banks as against the notes it issues when the law gives a first lien on all the assets of the bank and its stockholders and the liability of the assessment of the stockholders as security for the currency?

Mr. GILMAN. Yes ; that is the difference, and the liability to a lack of confidence. I will say the confidence comes in just at that point. This describes the method. The object is to make the banks sustain their customers as well as derive a profit from them. This they do by turning to the clearing house to find the remedy for a bank crisis, instead of throwing the whole pressure on the mercantile community, to use the words of Nathan Appleton. The result is that coöperation is thus established, which prevents the interests of the banks from being at variance with the interests of the people. A secured currency with a coöperative system will produce stability, and an unsecured currency, whether under the Suffolk system or any other, will produce panics.

Thereupon the committee adjourned.

THE LEEDS PROPOSALS

SPEECH ON ENGLISH BANK RESERVES

BY MR. GOSCHEN, CHANCELLOR OF THE EXCHEQUER, AT
LEEDS, JANUARY 28, 1891 ¹

MR. PRESIDENT AND GENTLEMEN, — I thank you most cordially for the magnificent hospitality which you have extended to me to-night, and for the warm welcome which you have given me. I have to thank the president for a most genial speech. [Hear, hear.]

Gentlemen, you have given me a cordial welcome, and we are now at an hour when generally genial after-dinner influences forbid the introduction of heavy or serious topics [laughter]; and it goes against the grain that I should have to requite your kindness by inflicting upon you a harangue upon some very serious aspects of our national, commercial and manufacturing life. I am anxious to speak to you upon a matter which cannot fail to be interesting to every man who is engaged in commerce and in trade, and that is upon the facilities of banking, upon the question of currency, upon the question of the attitude of

¹ From the *London Times* of January 29, 1891. This speech of Mr. Goschen's is here given, not only because it was asked for by the chairman of the Committee on Banking and Currency of the House of Representatives, but because it marks the beginning of a change in English banking methods, and is an admirable discussion of the subject of bank reserves, and is not easily accessible to the general reader. Parts not essential to this argument have been omitted.

this country with regard to its enormous liabilities, and the means with which it has to discharge those liabilities in a manner which shall redound to the credit of this country, and which may assist us in maintaining the splendid fabric of credit which has done so much to promote the prosperity of the people and has commanded the admiration of Europe and of America.

THE BARING CRISIS

Your president has alluded to the times through which we have passed. He has alluded to the state of things which in the months of November and December [1890] alarmed the country and created a feeling of tension such as has rarely been witnessed. [Cheers.] No fertile imagination could exaggerate the gravity of the crisis, and if I attempt to bring home to those who are listening to me now the serious nature of the crisis, I do so in order to accentuate the necessity of their turning their attention to what I may call the necessity for soundness in our banking and soundness in our currency transactions. [Cheers.] I doubt whether the public has thoroughly realized the extent of the danger to which what is called the banking crisis exposed us all. It was not a question of a narrow circle of financiers or traders. The liabilities were so gigantic, the position of the house was so unique, that interests were at stake far beyond individual fortunes, far beyond the fortunes of any class. We were on the brink of a crisis

through which it might have been difficult for the soundest to pass unscathed, for the wealthiest to have escaped. It was a time when none who had liabilities or engagements to pay could say how they could pay them if a condition of things were to continue under which securities could not be realized, under which produce could not be sold, under which bills could not be discounted, under which there appeared an absence of cash sufficient to discharge the liabilities of the general public. [Hear, hear.]

That was the position at home, and I tell you what was at stake — you risked the position of London as the banking centre of the universe. You risked the supremacy of English credit, you risked the transfer of the business of this country to other European centres, if such a catastrophe had occurred as you were on the eve of witnessing. I cannot exaggerate the danger, the immediate danger to which this country was exposed at that time, and we are under a deep debt of gratitude to the Bank of England [cheers], and to the Bank of England for the position which it took up which enabled us to tide over that crisis. I want to bring home to you here and to the public who are not in London, but in the various mercantile and producing parts of the country, that this was not only a banking danger. You know what it would have been if banks who hold your deposits, banks on whom you depended for your discounts, banks who supplied to you

the means of carrying on that active trade for which this town is renowned — you would have known it if these banks had been crippled, and crippled they would have been if that crisis had not been prevented. But beyond that the country should understand that it is through credit that the crops are moved — all those raw materials on which the life of this country depends. What is the ordinary means of sending cotton to this country? By bills on London houses. But to sell those bills you must have buyers, and for buyers you must have men who have confidence in the credit and solvency of London firms, and if that had been absent, how would you have been able to move produce from various countries to this? Simply by shipments of gold, and by no other means. Yes, you had securities, but who would buy them at that time, when men were unable to realize their assets, wishing to sell what they considered their wealth, but unable to utilize for the payment of their liabilities? And men trembled for their honor, they trembled for the name they had built up through scores of years; and they did not see how through the dangers which were surrounding them they were to be able to maintain their own personal name, and how the names of great houses in this country would be able to stand the crisis.

THE MEASURES TAKEN TO SAVE THE SITUATION

Gentlemen, I tell you you have escaped from a catastrophe to which the famous catastrophe of Overend and Gurney would have been child's play. [Cheers.] You have escaped from a catastrophe which would have affected every town in this country, which would have affected every industry; to use a common phrase, you have escaped "by the skin of your teeth." [Cheers.] Well, gentlemen, I ask you what were the measures taken; and mind I wish you to understand this, if I place before you — if I may use the phrase in its most hideous features — the dangers to which this country was exposed, I do so in order that we may see what was wrong and consider whether by prudent courses such a danger may never again be incurred. [Cheers.] Well, what saved the situation in one sense — in a narrow sense? I have told you it was saved in part by the capacity of those who were governing the Bank of England at the time. What measures were taken? They brought from France three millions of gold; they brought from Russia a million and a half of gold; knowing the panic that might ensue, knowing the rush that there would be on the reserve of the Bank of England, they took a preliminary precaution by extraordinary means, — for ordinary means would not have sufficed, — they took the extraordinary means of drawing to this country four millions and a half

of gold, or I might say five millions, as other measures were also taken. For that we depended in part on the good-will of the authorities of the Bank of France.

Paris was interested in saving the situation. Let there be no mistake about that. A crisis such as might have occurred in London could not have failed to have its counterpart in Paris and Berlin, and Paris would have suffered grievously if the catastrophe had not been avoided. But, nevertheless, the Bank of France acted with promptness and with courtesy, and the three millions of gold came from the Bank of France to the Bank of England, and were an element of strength at an important moment. [Cheers.] At the same time, there were some who considered that there must have been something wrong in the situation that it should have been necessary for this country, with its immense wealth, to have recourse to foreign aid on such an occasion as this. [Hear, hear.] Well, the Bank of England strengthened its resources, and, calling together the great banking institutions of this country, it secured a guarantee which saved that credit which it was so essential to save at that moment, — not the credit of the house, but the credit of London, the credit of England, and I rejoice to think that the credit was saved not by the action of the government, but that it was saved by the spontaneous efforts of the banking classes themselves. [Cheers.]

There were not wanting voices who gave utter-

ance to the view that it was the duty of the government on such an occasion to intervene, but it would have been a disaster. I should have been sorry to have had to come forward in the House of Commons, and to say that two or three years ago in Paris, when there was a panic through the breakdown of a great institution, the great firms and banks of Paris came together and saved the situation, but here in London it had been necessary to invoke the action of the government. I should have been ashamed if there had not been sufficient patriotism, sufficient public spirit, and sufficient gold in the financial institutions of this country to meet such a thing. [Cheers.]

What you want on these occasions is a leader ; you want a man. You want a man to come forward and say, " You all must do your duty." There was a temptation on the part of the banks, each one, to look to itself and to aggravate the crisis by calling in all its money, by refusing accommodation to customers, and in that way intensifying the feeling of anxiety which existed. There were moments when that was apprehended, but that movement vanished in a day ; it vanished when it was powerfully put to the great institutions of this country, — " Here is an occasion when, putting aside any timid counsel, you must come forward to endeavor to rescue the credit of London, not only to save a firm, but to save the supremacy of British credit."

CASH AND CREDIT

Well, gentlemen, it was done and the situation was saved. I have shown you how we got out of the difficulty. Two things were necessary: you had to find cash, you had to find gold, and you had to restore the credit. The gold was found; the reserve was increased by the efforts of the Bank of England, and the credit was saved by the action, the joint action of the great banking institutions of this country. But now, when the crisis was over, men began to say, "Why should we ever have got into this difficulty?" [Hear, hear.] Some said, "Oh, it is the fault of the Bank Charter Act." Others said the capital of the Bank of England was insufficient, and others said that there was not sufficient elasticity in our currency system—which means to say that the printing-office for printing bank notes is not put into sufficient activity in dangerous times. [Laughter.] Well, you, as men of business, I hope will understand that what is necessary to get men out of a difficulty when they have undertaken more liabilities than they can meet is to have cash. It is cash that is wanted.

In foreign liabilities—and on this occasion foreign liabilities were enormous, not only foreign liabilities of one firm, but the foreign liabilities of the nation—on these occasions bank notes are of no sufficient avail. What you want is cash—gold which will pay your liabilities in foreign

countries ; and the printing press at a moment of this kind is a danger, and not a resource. And that is what I want to bring home, if I can, to the public of this country, — that they will lean upon a reed which will break in their grasp, that they will be encouraging the most dangerous of ideas, if they think that any elasticity or increase in the currency or any measure of this kind would have saved them from such a danger as that to which they were lately exposed. [Hear, hear.]

Why, what do you want at such a moment? You want men who have ready cash with which they can step into the breach. You do not want institutions who have at the moment simply to realize everything they have got in order to meet their own enormous liabilities ; but you want some reserve that may come to the assistance of the community at large, and, stepping in, may assist those who have possibly overtraded, by purchasing a portion of their securities and taking over a portion of their assets. But that was not the case on the late occasion. What was developed was this, to my mind, — that there were not sufficient banking reserves in the country at that moment, and on that, if you will permit me, I wish presently to say another word or two of warning.

THE QUESTION OF GOLD

But I have spoken on the question of gold. Let it be thoroughly understood that in this country our liabilities are to pay in gold. That is all

the liability which we have undertaken to foreign countries ; it is a liability which the Bank of England undertakes to all who hold its notes. It is a truism to say so in a company such as this is, but it is one of those truisms which, like other truisms, are sometimes buried in the memory of men who do not like those truisms. [Laughter.]

And here is the position — that the very centre on which the pull comes has an infinitely smaller stock of that metal than any of the other countries who are in the same position. [Cheers.] For good or evil, the immense liabilities of this country would have to be discharged, if need there were, in gold ; and this country is that on which if three or four millions are wanted, the immediate pull comes in the first instance. We have got a very small available stock ready for the moment, and hence arise sudden changes in the value of money. If you have so small a stock of bullion and so small a reserve — and on that I will say something in a moment — if you have so small a reserve, it follows that any large amount or any comparatively small amount withdrawn from such a comparatively narrow base for carrying so enormous a pyramid, — these withdrawals have an effect which is disproportionate to the extent to which the gold is withdrawn or reserves diminished.

I tell you, not only as viewing the matter from the point of view of currency, not only from the point of view of one who has had some acquaintance with banking matters, but as one who

is responsible to others for the safety of the country, I consider that, looking to the fearful national emergencies which might come — but which, please God will not come, but which every statesman is bound to consider as possible — that the amount of central gold in the possession of this country, compared to the enormous amount at the disposal of other countries, is a matter which requires the attention of statesmen, and is one to which we ought to look with some anxiety, not overweening anxiety, but we ought to see whether we cannot contrive some methods by which we can alleviate special emergencies, and at the same time hold a large stock of bullion in reserve, not only for the banker, but for every possible emergency. That is the point upon which I wish to put in a word of warning. I will not be a party to the expulsion of gold from this country by any excessive issue of any fiduciary currency whatever. [Cheers.] If there is to be an increase of fiduciary issue I will endeavor to make it subservient to what I consider to be the primary point of being stronger, both for banking and for national purposes. For that object, and for that object alone, would I embark in any scheme such as the £1 note. I have spoken at some length, I am afraid. [Cries of “Go on.”] I have spoken with regard to gold.

THE CASH RESERVES OF ENGLAND

I come now to a point of scarcely less interest, and that is the cash reserves of the country, apart from the question of gold ; and there I must give utterance to a strong conviction which I hold, that the banking reserves of the country are inadequate to the necessities of the country, and are too small as compared with the gigantic liabilities which our large institutions have incurred. On that point I should wish to put a figure or two before you. They are stupendous figures. I wish to put this argument before you, — that in times of crises reserves are essential, and that it is of supreme importance that all the great banks of the country, at the moment when a crisis comes, should be able to afford relief to their customers rather than feel at that moment bound to curtail the facilities which they are giving.

It is all very well for banks to give facilities to their customers in good times, but a customer looks to the bank for facilities when the pinch comes, and if, when the pinch comes, the bank itself is obliged to draw in its resources, call in money, it disturbs the whole of the mercantile arrangements, and the bank is not really assisting the country, but is thwarting the best interests of the banking and trading communities. [Cheers.]

Listen to the figures. The “Economist” estimates the total deposits on current account held by all the banks in the United Kingdom, excluding the Bank

of England, in July, 1880, at from £470,000,000 to £480,000,000; and in July, 1890, at from £600,000,000 to £620,000,000, — an increase in those ten years of £130,000,000. I cannot tell you, because I have not got the materials at my command, to what extent they increased their reserve in cash in proportion to the enormous increase in their liabilities; but I can give you some indication by the published accounts of some of the largest bankers. According to the “Economist,” again, the liabilities of all large banks were, in 1879, £126,000,000, while their cash in hand or at the Bank of England amounted to £16,200,000; in 1889 the liabilities had risen to nearly £170,000,000, during those eleven years an increase of £44,000,000. But the cash balances had risen in the same time only to £17,500,000, an increase of £1,300,000. Observe the operation — £45,000,000 increase in liabilities to depositors; increase in cash reserve to meet them, £1,300,000. I hope I shall not give offense, but I say I do not consider that a perfectly satisfactory position. [Cheers.] On further examination I find the proportion of cash to liabilities had fallen during the ten years from 12.9 to 10.3, a decrease of 2.6 on 12.9, which is about one fifth of the whole reserve.

During these ten years the change is that you have only four fifths of the reserve, instead of the five fifths you had before; and in the case of one bank the percentage of cash to liabilities had sunk from nearly 22 per cent. to 12 per cent., and, in

another case, where the percentages had fallen from 10 per cent. to a little over 6 per cent., the cash balance against the total liabilities of £9,000,000 was less than £600,000. A good deal of public attention has been called to these facts. It has been shown that while the liabilities to the public have enormously increased, the reserve has actually fallen.

The reserve, let me make you clearly understand, is cash in the till, or cash at the Bank of England. Some banks include cash on call, but cash on call is no reserve in the general sense so far as the community is concerned, because it means when you call in your money on call that you are unbalancing another person, while you may be relieving yourself. Let the public understand this, — there is only a limited amount of money so unemployed. If everybody employs money up to the hilt there will be no unemployed money to come to the rescue in time of crisis. If you employ the money by lending it to another person you lend it to a broker. That broker cannot find the money except by going somewhere else. He goes somewhere else, and the whole in the end concentrates itself upon the Bank of England, and there is no reserve to a bank in having money on call¹ in the sense in which I am now discussing reserves. It is a valuable asset, but it is not an asset which consists in a reserve useful to the general interests of the community at large.

THE BANK OF ENGLAND AND OTHER BANKS

Now the banks, I believe, have taken up this position ; viz., that it is not good to hold large reserves, and that they have simply to put their money into the Bank of England, and that the Bank of England would then make interest upon that money. Look upon the crisis. What was the establishment upon which the whole community relied when the time of crisis came? It was the Bank of England, and the bankers themselves had to strengthen their reserves at the Bank of England, and were not able to bring that general alleviation to the community at large which was extended by the Bank of England.

I am most anxious to avoid saying anything which may reflect upon our great banking institutions. They have done immense service to the country. They have brought together in their deposits capital, which, being lent out again, has had fertilizing influences, and has assisted the commerce and industry of this country. [Cheers.] I say nothing against them. But I say it is a false system and a dangerous system to rely simply upon the aid the Bank of England can give in a crisis, and to take no thought whatever to meet the difficulties which might arise, except by such action as the Bank of England may possibly take, as they think, with the government behind the Bank of England. I should be glad to be able to devise some system, and I am engaged, and hope-

fully engaged, with the assistance of the authorities of the Bank of England, in devising a scheme by which we may strengthen the permanent reserves of this country, by which we may give greater help in emergencies, and by which we hope that some of those fearful catastrophes which have sometimes threatened the commerce of this country may be avoided. [Cheers.] I am engaged on plans of that kind, and I trust I may be able to give effect to them. But we shall only aggravate, we shall not alleviate, the position if any relief given in the hope of a second reserve, besides the first reserve, should have the effect of inducing the joint-stock bankers to trade further up to the hilt than they have hitherto; if we should encourage the belief that there is safety at the centre, and therefore that to any extent we may invest our deposits, and that we may rely, instead of holding our own reserves, on the action of the Bank of England and the government.

Unless I saw some disposition on the part of the bankers of this country to take their share in any reforms that may be necessary, unless I saw a disposition to assure us that this country is not again to be at the mercy of foreign countries — that we are not to be obliged to import gold from abroad, that we should not be at the mercy of such circumstances as have lately occurred — I say that the great banking institutions of this country are bound to take their share in endeavoring to bring about such a result. [Cheers.]

Gentlemen, the public has some *locus standi* in this matter. The position in former times was this, that the Bank of England was an institution so vastly greater than all the others that it was able to command the money market and impose its terms. Those times have changed. There are two banks who hold between them £80,000,000 of deposits against the £34,000,000 deposits of the Bank of England. The position of the Bank of England is changed in that respect. It has still the duty of endeavoring to meet all the necessities of a crisis ; it still fills such a position that the whole of the country looks to it to extricate it from a difficulty, but it does not command any longer the same proportionate resources which it commanded in the old times. It is unable at this moment, in the face of this £600,000,000 of deposits intrusted to other banks, to take the same position as in times past.

THE RESERVES OF JOINT-STOCK BANKS

Now, in America there is a limitation imposed upon private bankers which is of a very remarkable character. The national banks are obliged to hold twenty-five per cent. in reserve against their deposits. Those are the issuing banks, it is true, but the state has considered that it is so important that those banks shall meet all their liabilities that it has imposed an iron limit of twenty-five per cent. in reserve against their deposits. I am bound to say that I should never propose to impose such an

iron system upon the great banking institutions of this country ; but I mention it to show what in a free country such as America they do. The question of the proportion of deposits to liabilities was so serious that they introduced a cast-iron system. Then there were other suggestions, that if there were an excess of deposits and liabilities, up beyond a certain line, then that should be done which is done in some foreign lands, — they should have to pay a certain tax upon the excess of their deposits.

I will not say what view I hold upon such a suggestion, but in the most friendly spirit I would indicate to the banks of this country that the public have an enormous interest in the proportion of the reserve which they hold to deposits. They all hold together ; and you have this remarkable fact, that the soundest and strongest banks may be making the smallest dividends, whilst the more imprudent banks, who invest the depositors' money, leaving a small reserve, are able to show much larger dividends to their shareholders. Why are the latter able to take this course ? Because they may have the conviction that the failure of any one of these big banks would be such a disaster to the whole community that the other banks would be compelled to come to their assistance, and to rescue the offending banks from the consequence of its offenses by themselves undertaking a part of their liabilities. The more imprudent banks will say, " There is no

imprudence. We shall never be allowed to fail; our fellow bankers must come to our assistance, and, if not our fellow bankers, then the Bank of England; and if not the Bank of England, then the government." I say that gives us a *locus standi*, and in the same way as the government has had a *locus standi* with regard to shipping and has said that excessive cargoes shall not be carried because they are dangerous to the safety of the public, the question may arise whether the public might have the right to say that no excessive cargo shall be carried by a bank receiving public money—that business shall be conducted in a manner which shall be considered safe by the community at large. [Cheers.] There is one measure which I think may fairly be taken, and which the public would have a right to demand, and that is, the more frequent publication of accounts.

I say that there ought to be some effort made in this direction of coöperation, and if it were made, and if I saw that there was a tendency in that direction, I can see what measures might be taken to establish what I have indicated as a second reserve for the country at large.

SUGGESTED IMPROVEMENTS IN THE CURRENCY

I come now, and I will endeavor not to detain you much longer, to a point which perhaps will be more interesting to you than a description of the situation—namely, the point of suggesting improvements in our currency and banking system.

[Cheers.] If you have done me the honor to follow my arguments so far, you will have seen that I thought that our gold reserve in this country was generally insufficient, and that generally our cash reserves were also insufficient. I am not content to see the violent fluctuations, which are possibly inevitable. I am not content to see their continuance, at least without considering whether some legislation cannot be devised upon the soundest and the most orthodox principles. But you will see there is one point upon which I am extremely strong, and that is that you should not devise any means to alleviate the situation which would mean a further expulsion of gold. [Hear, hear.] Now, there is a favorite measure in the air, which is the increase of the fiduciary issue; and many persons think that would be an advantage. An increase of the fiduciary issue means, as I understand it, the substitution of paper for gold.

Now, supposing you were to issue £20,000,000 of £1 notes, and they were to take the place of £20,000,000 in sovereigns in the pockets of the people, or the tills of the banks, what would happen to this £20,000,000 of gold? It is the opinion of those who are in favor of this substitution that £20,000,000 would be added to our stock of gold. [A voice. — “Yes.”] No, that would not be added to our stock of gold. It would go to the reserve of the Bank of England for the moment, but afterwards it would, like all our gold, be open to the world at large; and the gold which we had

called in, replacing it by notes, being added to the reserve at the bank, would in the first instance, as do all other additions to the reserve, lower the rate of interest, would create great speculation for the moment, and would lead to the export of gold to other countries; and having substituted paper for gold, you would find that really you have not strengthened the reserve of gold except by a small portion, whatever it might be that we might gain. I cannot tell you the importance I attach to a thorough understanding of this principle by the people at large. They believe that if we were to substitute paper for gold we could keep gold under the ordinary arrangements of our Bank Charter Act. It is nothing of the kind. Paper expels gold unless you take particular precautions to retain the gold; and for my part I am totally opposed to any measure which would simply end in the expulsion of gold from the circulation of this country. We should keep our £25,000,000. We might, perhaps, increase them to £26,000,000 or £27,000,000. We should have done no more. But any movement to which I would be a party in the direction of the fiduciary issue must have this result — that you must stop the gold; that the bullion and the gold which would be brought by the public in exchange for the £1 notes, or any other form of notes, should be dealt with in such a manner as not to leave the country. I would establish it as a second reserve, not to be put into the ordinary issue; but I would have a separate

stock of gold realized to this country by a certain issue of paper money which was to be issued only when emergencies should arise. [Cheers.] I think that in a very few minutes I can make that clear. I do not know whether I have been able to make this portion — I will not say of my plan, but of my principle — clear to those whom I am addressing. But what I mean is this. When, now, there is a suspension of the Bank Charter Act, you suspend the Bank Charter Act by a simple issue of paper, unsupported by gold, and sometimes almost adding to the dangers of the situation by increasing your paper money at a time when gold is leaving the country.

A SEPARATE STOCK OF GOLD

Well, it would be infinitely better if there existed in this country a reserve of gold, a separate stock of gold, with which, in time of emergency, the Bank of England would be able to come to the rescue of the mercantile community generally. My object would be to establish a second reserve — a reserve which we should be able to establish by means of a certain fiduciary issue — and that this second reserve, under conditions to be defined, should take the place of the suspension of the Bank Charter Act by providing the means of the further issue by safe notes, when the position of the country might seem to demand it. If such a stock had existed it would have been unnecessary to have applied to the Bank of France or to the

government of Russia, or to have gone to any other country to increase your stock of gold at a given moment.

I ask you now to return for one second to the point which I laid down at the beginning of my speech. I pointed out to you the small amount of bullion which we held, and showed to you that in my judgment that amount of bullion ought to be increased. I have now indicated a method by which I think it might be increased, and might be increased without imposing any tax on any portion of the community, but it would be secured by the state foregoing a portion of the profit which it would make upon the fiduciary issue. A certain amount of gold would be lying idle, and men would say, "Why should that gold remain idle? What a sacrifice! Why is it so?" Well, it would be the state which would have foregone a portion of the profit which it made on the fiduciary issue, and it could say, "It is of such enormous importance there should be a larger reserve of bullion in the country that we have foregone this profit which we may have made upon our paper issues because we believe it to be better to secure a reserve to which in times of crisis you may apply." [Cheers.]

Such a solution would only be proper, such a solution could only be defended, if conditions were imposed which did not aggravate the situation at the time. It would be improper to touch such a store of gold if the exchanges were against this

country. It would be improper to touch such a reserve if the rate of interest were not at such a point as to be likely to attract gold from other countries. Do not let us look to anything which would for a moment palliate the difficulty, but which would afterwards aggravate the catastrophe which we are endeavoring to avoid.

I have sought in these matters to see how, under the most orthodox system, and leaving the Bank Charter practically intact, we might secure a second reserve to the country. I think I am bound to inform you that, in this matter, I have been in communication with the authorities of the Bank of England. It is possible I am not authorized to say we are agreed upon any plan. We are working at a plan, and endeavoring to see whether some plan cannot be devised by which these violent fluctuations, these internal panics, can be avoided. It is difficult to deal with an external panic ; but an internal panic might be saved by a further issue of notes, not, as at present, on credit, but against a reserve which has accumulated by such measures as I have endeavored to describe.

An after-dinner atmosphere is not one which is fit for the discussion of such subjects as I have intruded upon you ; but remember the words, if you will be kind enough to do so, with which I introduced these lengthy remarks. Remember these are not matters which concern only the banking community and are only matters of

high abstract theory, but they are immediate matters of practical interest. If we can secure that there shall not be those violent fluctuations, if we can avoid an occasional panic, or mitigate such panics as cannot be avoided, we shall have done something which may not, I hope, be regarded by our fellow countrymen as unworthy of their support or unworthy of their commendation. [Loud cheers.]

IV

FALLACIES IN "BANKING UPON BUSINESS ASSETS"

A TRACT entitled "Banking upon Business Assets, What the Experience of Nations has been," was printed in Indianapolis, Ind., in 1898, and bears the caption "Part of Congressional Record."

In this tract there are fallacies in the arguments in favor of "Banking upon Business Assets" which in the interest of business men should be explained so as to be clearly understood by all.

A fallacy is a concealed defect in an argument supported by an open statement of facts and principles generally acknowledged to be true. The defect may be concealed by design or ignorant good faith, or by simple unpremeditated omission. It may exist because the facts and principles stated are not as far reaching as the conclusion drawn from them. The facts and principles may govern as far as they go, but they may not go as far as the conclusion claims they go. The best intentioned logic often has a catch or a trap in it which is hidden even to the framer of the argument.

A fallacy, of whatever kind, deprives an argu-

ment of its force, and makes its conclusions untrue. A fallacious argument starts with a universally accepted truth, in this case that banking assets are the true basis against which bank notes should be issued, and then proceeds to apply it in a way dictated by ulterior motives, which in this case are to secure an advantage for a private profit. It is the old ruse of stealing the livery of heaven.

The argument contained in the tract "Banking upon Business Assets" is that such assets are the only true basis for a bank note circulation; that their use in this way is the universal practice of the chief commercial nations of the world; that the safeguards which can be thrown around such a currency will make it safe and sound to the holder, and therefore the active efforts of all business men are solicited and should be given to help pass the bill known as the Indianapolis Convention Bill, which gives to three or four thousand banks the power to bank upon business assets, or in other words issue currency on their bank assets, retaining them in their own possession.

The first fallacy in this argument, for there are more than one, is shown when a business man asks how this bank currency is to be issued and made good.

The answer as to the mode of issue is this: that under the proposed system the bank will ask the business man to give it good collateral and his note, which thereby becomes a lien on his estate, and it will then give him, less the discount, its

circulating notes, which he can use in buying a stock in trade. The bank will further explain that it will make similar loans to the full extent of its legal power to other business men, so as to make as much money as possible out of this privilege.

The business man will then ask how the notes are to be made good. The bank answers that if all goes well the business man will sell enough of his stock in trade to pay his notes by the time they mature. But the business man, being inclined to prudence, asks what will be the result if his notes mature on a panicky market when he cannot sell at a profit. The plain and disagreeable answer deprived of all circumlocution is that if the borrower engages to pay a certain sum of money at a fixed time he must perform his engagement, for the bank has its engagements to fulfill, and may need the money to preserve its solvency. The business man then sees that the soundness of this currency, which is so extolled, is maintained at his expense ; that besides the risk of his business, he is taking the risk of the money market ; that the lien on his estate which he gave the bank may require him, in event of a monetary disturbance, to sacrifice so much of his property as will protect the bank.

The argument then in favor of the soundness of the currency issued on business assets is that enough cash can always be had by a sacrifice of the assets of business men to make the currency

perfectly good, or in other words that the business houses who pledge their assets have sufficient capital in their business to yield enough cash under pressure to pay their bank debts even at panic prices. So the resource the banks contemplate in connection with their bill for banking on business assets is upon the estates of their borrowers, and they are willing to engage to get enough money from this source to keep their bank notes good, so that no holder shall ever lose a dollar thereby.

So we discover a fallacy in the claim that bank currency issued on business assets is so good that no holder can ever lose by it, in the method that the banks propose to adopt to make this currency good. What is the advantage in protecting the holder of the currency from loss by inflicting a loss upon the borrower? Is it a full and true statement of the case to laud and magnify the soundness of the currency and its freedom from loss, and say nothing about the greater loss which the business man is most vitally interested in, which results from the effort of the bank to keep the currency sound?

"The demand of a crisis or a change in the commercial situation," says the writer of "*Banking upon Business Assets*," "often makes it necessary for a banking institution to redeem a large part of its note issues in cash to pay off depositors in cash, and to contract at once the volume of its issues and its discounts." The contraction of the volume of discounts in a crisis to supply the banks

with the cash to redeem their notes may make the notes good, but it is done at the expense of those who have discounted their notes at the banks. Is it not a specious argument to claim that "the issue of notes upon business assets is abundantly safe to the note-holder," and to say nothing of the great losses which the contraction of such a currency inflicts upon the commercial community?

That such "changes in the commercial situation" otherwise called "crises" or panics must be anticipated, is acknowledged by the writer of "*Banking on Business Assets*." They began to occur a few years after the establishment of the modern credit system two hundred years ago, when the Bank of England was incorporated. In the Bullion Report of 1810, they are called those "occasional failures of confidence which are inseparable from the credit system." The financial history of the United States and England during the last twenty years shows that the liability to panics still continues, at the end of these two centuries, as one of the most prominent factors of business life. Panics therefore cannot be waved aside as events not likely to recur.

The answer of the bank to the question of the business man as to how the proposed asset currency is to be made good in the stress of panic, when reduced to its fewest possible words, must therefore be "Out of your estate." This is the currency which its advocates claim is entirely safe, and can cause no loss to the holder. The fallacy

in the argument is that it may cause ruin to the borrower. It is not claimed, because it cannot be, that such currency will not produce a loss ; therefore the freedom from loss is limited to the holder, as if he were the only one to be considered, and as if that constituted a safe and harmless currency. The safety is partial, the destruction is universal. What is wanted is a currency which is both safe to the holder and safe to the borrower also. This can be reached by giving the banks another way of making their obligations good besides forcing liquidations on the public, and that is accomplished by giving them access to a source of supply of undoubted credit, ample enough to meet all their wants, to which they can go without disturbing business.

Another fallacy which should be exposed lurks in the argument that since bank currency is issued on business assets by the banks of France and Germany and of other civilized nations, we would follow the best examples by giving the same privilege to the banks of the United States. On the contrary, to do so would be a most flagrant departure from the examples of the countries named.

If the laws of France are referred to it appears that the power to issue currency is limited to one establishment of credit, the Bank of France. French writers and members of the Assembly, in their debates over the Charter of the Bank of France in 1847, when it took its present form, unite in advocating a single source for the emis-

sion of bank bills. Their contention was that it is a function of the government to provide a circulating medium, and if the government delegates its authority it must be with such restrictions that the money authorized shall be able to circulate freely throughout the entire nation. In Germany a similar restriction is imposed on the issue of bank currency, and only six banks have that privilege. The fallacy in the argument is shown if it is baldly stated that, since the power of issue on bank assets is granted to one bank in France and six in Germany, therefore it would be well to give the same power to four thousand banks in the United States. Even the most casual reader will recognize that the very essence of French and German legislation is the restriction to the smallest possible number of the power to issue bank currency. A truer statement would be that since the power to issue bank currency on business assets is restricted in France and Germany to but few banks, therefore the same power should be given to but few banks in the United States; and as the banks in France and Germany possessing this power are of a higher grade than the popular or commercial banks of those nations, therefore the power to issue should be given in the United States only to institutions like our clearing houses, who, while intimately connected with our popular commercial banks, are still one remove farther than they from the pressure of commercial interests.

That the bestowal of the power of issue upon

four thousand banks, each one in that respect the peer of the Bank of France, would sooner or later be attended with a period of "failure of confidence in the credit system" will hardly be questioned by any who are versed in financial affairs. The restriction of the power of issue in few hands becomes therefore a vital necessity in forming our banking system, and this point is entirely evaded by the writer of the tract "Banking upon Business Assets."

Another fallacy is in the comparison of bank note issues secured by pledge with a state official of state securities before the Civil War, and note issues on bank assets by banks who had in their own hands the security to their notes. The two points of comparison are here confused. The comparison should first be on the advantages and disadvantages of a currency secured by pledge of assets in the hands of a trustee or of a currency issued against assets remaining in the hands of the bank. This comparison has nothing to do with the character of the assets, but only with the mode of issue. Assuming that the assets on which this currency is issued were alike in both cases, the question is which method is the best and safest for the community, — to have the assets held by a trustee for the benefit of the note-holder, or to have them remain in the hands of the issuing bank.

For instance, would the national bank currency be just as safe if the \$300,000,000 of government bonds now held by the Treasurer of the United States in trust for the note-holders, were

returned to the possession and custody of the banks whose notes are outstanding against them? Or, taking another instance, would a currency issued on bank assets in the hands of a loan committee be no safer than a currency on bank assets held by the bank? The answer must necessarily be that if there are four thousand issuing banks, it is far safer for the public to have the services of a trustee to hold the security. A trusteeship gives the public a guarantee of the safe custody of the collateral and its right application for the purpose for which it was pledged. A trusteeship also causes a scrutiny of the collateral and a certain measure of publicity in the transaction which cannot fail to be salutary. If the board of directors of any one of four thousand banks can close the transaction of a note issue in their back parlor and pass upon the security without supervision, their cupidity will too often get the better of their judgment, and the foundation will be laid for "a failure of confidence in the credit system." Even the directors of the Bank of England erred in this way, and the sharp criticism of their conduct was perhaps the chief cause of the passage of Peel's bill of 1844, which took out of their hands the power of note issue. How much more liable to such errors would be the directors of four thousand banks scattered all over our country!

The comparison should be, second, on the desirability of limiting the security for circulation to specific classes of assets like government bonds, or

allowing bank notes to be issued on business assets. Here it is easy to agree with the writer of "Banking upon Business Assets." The National Bank Act allows the banks to invest their money in various kinds of quick securities called for convenience business assets, and it prohibits banks from holding real estate beyond a certain period. These provisions are intended to keep bank assets in quick or liquid condition. It is evident that it is not only reasonable, but it is demanded, in the interest of commerce, that banks should be able to use these same assets in procuring currency. First, the assets should be liquid, and second, the banks should be able to turn them into currency at will for their own and their customers' protection. This can be done by incorporating the clearing houses under a federal law to qualify them to act as trustees for the public and then giving them the power to receive and hold bank assets and issue bank currency thereon with a safe margin for the protection of the note-holder, any resulting loss to be assessed first on the members of the issuing clearing house.

The fallacy can readily be seen in the argument which condenses two comparisons into one and ignores the fundamental premise of each. The deduction is necessarily false and the conclusion untrue. The principle of a trusteeship to hold the collateral for the currency is demanded under a general law, and the trustee should be allowed to receive business assets as such collateral. The

existence of a trusteeship protects the community against a "failure of confidence in the credit system," and the privilege of using bank assets for bank currency gives the banks a resource besides contracting the volume of discounts at the expense of borrowers.

But the bill advocated by the writer of "*Banking upon Business Assets*" does not propose a trusteeship for the benefit of the note-holder, nor does it propose a mode of protection for the borrower. It is a bill for private profit, and the "variance between the bank and its customer" which S. Hooper, M. C., a merchant of Boston, noticed a generation ago, is perpetuated. Business men should understand that the principle of the Indianapolis Convention bill, advocated by the writer of "*Banking upon Business Assets*," is specious and dangerous, and affords them no relief from the burdens and defects of the present system. The abandonment of a trusteeship for the currency is incompatible with a general law.

It also proposes a system of branch banking which is un-American, the discussion of which is to be found on page 258.

A comparison between systems of banking prevailing in the United States is not a simple one. Banking on bank assets in the hands of the issuing banks caused the panic of 1837. Would not the same principle, put in practice in the same way at the present time, ultimately produce the same results? What is the worth of experience?

Compare the banks of 1837 holding the security in their own hands and the banks of 1898 who have pledged government bonds at Washington, and then answer which produces the safest currency. The banking system of 1837 was successful in one aspect. After the liquidation took place, by which it was estimated the country lost six thousand millions of dollars, the banks had realized enough cash from the estates of borrowers to enable a good portion of them to resume, and many of them paid their notes in gold. During the suspension some continued to pay dividends. Can a system be called successful which recovers itself at such a fearful loss to the business community? The banks first invited borrowers to take money, and then compelled repayment with the attendant sacrifices.

But the comparison is not probably intended to be made between the banks of 1837 and 1898, though they represent the two systems in their most distinctive character, but between the note issues on bond security from 1838 to 1850 and note issues on bank assets up to 1860, omitting all reference of course to the liquidations, panics, and misery caused in the process of making the bank asset currency good. Peace reigned in Warsaw after the country had been devastated, and so the asset currency of many banks has been triumphantly redeemed by the slaughter of business houses when none were left to tell the tale of what the redemption cost.

The true comparison is between the effect on the nation of a currency secured by assets as collateral security thereto in the hands of a trustee and one secured by assets in the hands of the issuer. Whether the currency is based on government bonds or banking assets, is it better to have the government bonds or the banking assets in the hands of a trustee or in the hands of the bank?

The answer is that it is better to have the security held by a trustee, because the payment of the notes is thereby better assured, and the notes become more acceptable to the public, and they may be used by banks in meeting the demands of depositors, and above all they give the banks another way of realizing money on the debts of their customers instead of restricting business and forcing liquidations and creating panics.

Senator Rives, of Virginia, said before the Senate, in debate on Webster's "Plan for an Exchequer," on December 29, 1841, "Ricardo's principle is that the power of issue is a power to create, while the power of banking is a power to use." The principle is as true to-day as when Rives quoted it. The banks are called into being to do business in the money coined and created by the government. And since it is a useless waste to keep all banking deposits idle, banking laws allow banks to lend their deposits, keeping only a safe reserve in cash; and since occasional crises occur when a greater amount of undoubted money is needed than the reserve provides, therefore the

government should make special provision for the issue to banks of currency sufficient for their needs, so that they shall not be compelled to harass their debtors. This currency must therefore be issued on the assets of banks ; and to make the currency independent of the banks, so that they can use it in payment of their debts, it must be issued by corporations acting as trustees for the public. By this method a currency is formed which would be safe to the holder and a protection to the business community, including the agricultural, manufacturing, and trading interests.

No day of retribution for the country would follow the issue of currency in this way ; there would be no waking up to find that the banking system had been founded upon a fallacy.

V

A CENTURY OF PANICS ¹

What is money?

1. It is clear that the coin of the realm is money, and its chief quality is that it may be used as a legal tender in the payment of debts.

2. Paper issued by the government and declared to be legal tender is also money.

3. Paper in the form of bank notes, and authorized by law to be circulated as money, is money, provided the maker is solvent, and the creditor will accept it, and the credit system is maintained.

4. Paper in the form of checks on banks or individuals which transfer a debt is money, provided again that the maker is solvent and the creditor will accept it, and the credit system is maintained.

5. The credits on the books of banks and individuals which may be transferred as money by checks are money. They are money *in posse*, that is, book credits can be turned into money at the will of the creditor. They are money as long as the credit system works smoothly.

¹ A paper read before the Anthropological Society of Yonkers, New York.

These five classes of money can be reduced to two. One class is money made legal tender by law, which is either coin or government paper. The other is bank notes, checks and book credits, which are either authorized by law to circulate as money, or are permitted to do so by common law.

The law authorizes bank notes to be circulated as money, but does not compel the public to take them. The banks can circulate them only as they find persons ready to accept them. The law does not take cognizance of checks, except in some States to forbid their issue unless the drawer has a credit balance with the drawee equal to the amount of the check. Checks are not illegal, and when they do circulate they perform the functions of money and can be cashed and must be considered as money. So bank and other book credits must be considered as money, because they can be checked for and thus turned into money, and while the credit system is maintained the banks and all solvent parties profess and claim and announce that they will pay on demand their book credits on presentation of checks. These book credits and checks transferring them constitute the bulk of the money of the country. But checks and credits can be money only if the credit system is maintained.

So after answering the question, What is money, we must next ask, What is the credit system, the maintenance of which is necessary to the existence of the greatest part of the money of a country.

Why does the quantity of money in a country depend on the maintenance of the credit system?

The modern credit system began by the establishment of the Bank of England in 1694. The theory on which it is based is that if a number of people deposit coin with a bank, by the laws of averages and probabilities, they will not all want their money at the same time. Consequently if a reserve of one quarter or one third of the coin is kept on hand, it will be sufficient to supply all ordinary demands of depositors. If more cash is needed, the reserve will afford sufficient time to collect from debtors enough additional money to pay all demands. By this application of the laws of averages and probabilities, and often with a good deal of reliance on the law of chances, the bank can with more or less safety lend the balance of the deposits, $66\frac{2}{3}$ or 75 or 85 per cent., on short time at interest.

The $66\frac{2}{3}$ or 75 or 85 per cent. of the deposit which is loaned is therefore doing a double service, and the interest on the extra service gives his profit to the banker. The money is circulating in trade, and yet the depositor considers it as cash to his credit in bank, because the bank engages to produce it when wanted. The bank, however, relies on the laws of averages and probabilities and chances to enable it to perform its obligations.

Our legislatures and Congress recognize the safety of a reliance on these abstract laws, and they authorize banks to do business on this theory,

and therefore the credit system has been incorporated into the law of the land. The same theories are put into practice by all business men in the conduct of their business, and so the principles of the credit system enter into all commercial transactions.

On these theories the credit system is based. The profit resulting from thus economizing the use of capital and multiplying its benefits fully warrants the remark of Webster, "Credit has done more to enrich nations a thousand times than all the mines of all the world."

The original method of banking operations was the reverse of the check system of the present day, but the credit theory was the same. Instead of placing a loan to the credit of a borrower the bank would deliver to him its notes to the full amount of the loan, which he put into circulation at his convenience. The reverse of this operation, that is, the check system, now universally adopted, was introduced in 1793, as a result of the panic of that year and as a means of circumventing the legal provisions on which was based the monopoly of the Bank of England.

The credit system, we see from this short summary, has been on trial for the two centuries since the establishment of the Bank of England in 1694. A comparison of these two centuries as respects the condition of commerce, the advancement of civilization and science and mental activity, shows that the first was a century of inaction

and quiet and preparation, and the second was full of modern life and business progress and realization.

A century or two gives after all but a short base line for a survey of theories and principles. After the second or the third or the tenth or the fiftieth century we find questions like that of capital punishment still debated and still unsettled. A century is but a short time in which to test a principle of government, or to put a government itself to the test. It is a short-lived nation that takes no longer than a century to rise and less than a century to fall. The modern system of credit being now about two centuries old, a time has come when at least an observation or a survey can be taken.

The two centuries of its existence are radically different in the tests to which it was exposed, as well as in the character of the events of each. The first few years after the development of the credit system are fruitful for economic study. In 1696, two years after its establishment, the Bank of England was obliged to suspend payment of its notes in specie, because it pushed the credit theory too far by lending ninety-eight per cent. of its means and having only two per cent. on hand as a reserve. Montague, the astute finance minister of William the Third, having a clear understanding of banking questions, devised an issue of government currency, called exchequer bills, to support the newly inaugurated credit system. This issue of bills relieved the distresses of the mercantile commu-

nity, helped the Bank of England out of its difficulties, and restored the credit system to successful operation. Whether or not Montague's exchequer bills were the prototypes of our modern clearing-house certificates, it is remarkable that assistance from such an adjunct was found necessary so early in the history of the credit system.

It would seem that the whole subject of credit was exploited to its inmost recesses by the business men and bankers and statesmen of that day. No wonder the people of France and England went mad over this new method by which poverty was to be banished from the earth and luxury was to be the common lot of all. There would appear to be no devices now used on our stock exchanges which were not familiar to all classes then. Paper wealth poured in on the people, and their frenzied intoxication over their financial happiness knew no bounds. But alas! Law's Mississippi scheme and the South Sea bubble were both pricked, and in the reaction the whole credit system was condemned and almost abandoned. Few, if any, books on the credit system were written after Law's profound works. Credit had a brilliant opening, and its possibilities were worked out to the uttermost. It was like liquid air, beautiful and fascinating to look upon, but with a tendency to blow up every one that experimented with it, and it seemed doubtful whether it could ever be put to a practical use.

Omitting these extravagant financial episodes,

and the shy at the first start which Montague so sagaciously controlled, the first century of the credit system was one marked by the domination of old beliefs and thought. The splendid page of history written by the Puritans was followed by the enervating influence of a self-indulgent aristocracy. There was no general awakening until toward the close of that century, when the revolutionary storms swept over two continents, breaking up the crusts of ages and brushing away the growths of centuries. During that first century the same text-books were used by students at Harvard College almost one hundred years apart. Our ancestors led happy and undisturbed lives, walking in the same steps for generation after generation. Banking was confined within narrow limits by this stagnation. England and America, compared with other civilized countries, were backward in the development of internal improvements. In America the issue of colonial currency only made the poverty worse. In England the chief financial discussions were over the debasement and clipping of the coins.

During that first century England was engaged in the wars necessary to consolidate the British Isles under one government and to establish her priority among the nations of the earth. An irrepressible conflict with France for leadership in Europe and America ended by placing England in that coveted position. The innate force of the Anglo-Saxon race impelled them forward. Com-

merce and trade waited for this conflict to end. The question was whether England was to be an insular or a world power, and whether or no the Anglo-Saxon race was to arouse itself from an ignoble lethargy that had settled upon it. At the close of the first century of the history of modern credit, the change had taken place. The position of the Anglo-Saxon race was secured. The issue of government paper was condemned. The uniformity of the coinage was established.

The Bank of England had been the greatest bank in the world during all that century, and had easily performed all banking functions for England. Possessing a monopoly, without restriction, there was no other bank at all comparable with it. Having a capital of over \$50,000,000, it was the marvel of Christendom. But with the advent of priority among nations, a different state of affairs rapidly developed. In 1750 there were but twenty banks in London, in 1790 there were over four hundred. From 1775 to 1793 the commerce and trade of England received a great impetus.

In that time Brindley, who has been called "the father of the modern commercial greatness of England," began the development of the canal system which made the commerce of the interior cities possible. Arkwright invented his spinning machine and Watt his steam engine, and with the successful application of machinery to the industrial arts, England began to supply the markets of the world and rose to the highest point of material

prosperity. With the awakening in business came the revolutions which founded constitutional government, which overthrew the ancient artificial systems in science and founded the natural, and all was accompanied by an outburst of modern music in a major key to complete the semblance of a triumphal march to usher in modern civilization.

With the increase of commerce the relative position of the Bank of England was changed. The bank had been able to maintain order and stability when there were twenty banks in London, when stage coaches were the speediest mode of travel, and commerce was confined to tide water. But the increase to four hundred banks, and the development of manufactures, and the invention of machinery, and the use of steam, and the completion of the canal system, reduced her power to control the money market in proportion to the growth of business to be facilitated and controlled. The reserve which had been ample for business before the rise of manufactures and commerce, and before the markets of the world were opened to England, thereafter became inadequate, and vulnerable to attacks from loss of confidence. The Bank of England became dwarfed by the modern structures which grew up around it. The credit system was to be put to new trials thereafter.

The first test came in 1793. There had been and could have been no such test in the one hundred years since the establishment of the bank. The occasion of the panic of 1793 was the declaration

of war by France, which threatened the trade of England and her commercial supremacy. A few failures took place in the early months of 1793, and every bank and business house from the Bank of England down became alarmed and began to hoard guineas to strengthen their reserves. The credit system began to tremble. The question asked with bated breath was, What will happen if the reserves of the Bank of England are not sufficient to pay all demands? This inaugurated the panic. It was the first modern panic, and in all points it was like that of 1893, and of every one in this century of panics. There had been incipient panics before, as in 1772, mere rumblings of the approaching storm, but the power of the giant bank was able to quell them. Now a panic arose which was greater than that power.

It is a piece of good fortune that when the panic of 1793 was over, Sir Francis Baring, the founder of the house of Baring Brothers & Co., wrote a book for which the convulsion of 1793 was the apology. It seemed to him out of place for a banker to write a book, but it may be said he rendered no greater public service in amassing his great fortune than he did in writing his small book. It contains expert testimony by an eyewitness of and participant in the first panic. The situation arose from the facts which have just been detailed, — the enormous increase of business, requiring a corresponding increase of currency and of banking facilities. Banking capital had been easily

obtained, and the many new banks organized issued their notes freely, checks being comparatively unused. The banks were well protected with security, and while credit was undisturbed business went on swimmingly. The notes outstanding were equivalent to banking deposits of our day, and were subject to the same increase and diminution. A reserve of coin would therefore be calculated on the amount of notes outstanding, as it is now on deposits. When a lack of confidence was aroused by a few failures, then note-holders began to present the notes for redemption, and soon the reserves of the country banks ran so low that they were unable to renew loans to their customers. Money then became so scarce that no purchasers could be found for the securities, however good, held by the country banks. Failures increased in number, and the country banks began to call on London bankers for money. Then London began to feel a currency famine. The ability of the banks of London to pay their obligations in cash began to be doubted. The lack of confidence was directed toward the credit system. Redemption of bank obligations was the one thing desired by the public, and that compelled the banks to force liquidations on their debtors to supply themselves with the guineas. The Bank of England then as now held the reserves of London banks, and holders of her notes began to present them for payment. "Then the directors," writes Sir Francis Baring, "caught the panic; their

nerves could not stand the daily and constant demand for guineas — and for the purpose of checking the demand they curtailed their discounts to a point never before experienced. . . . Their determination and the extent to which it was carried came like an electric shock,” producing “a dreadful convulsion.” Sir Francis Baring’s comment at this point explains the whole difficulty in this panic of 1793, and in the panic of 1893, and in every one which has occurred in this century of panics. He writes, “In such cases the banks are not an intermediate body or power ; there is no resource on their refusal, for they are a *dernier ressort*.” This answers the question why the public were so panic-stricken and so eager to draw their funds from the banks. Their action was based on the knowledge that a reserve in cash of ten, twenty, or thirty per cent. of deposits may be sufficient for ordinary times, but in a panic that percentage may all vanish in a few days, and those who come last may find the bank’s doors closed. “There is no resource on their refusal,” and therefore a panic under such a system is most logical and rational.

It is evident that if the panic is based on the fact that there is “no resource” in the event of the refusal of the banks to pay, the simple way out of the dilemma is to create a resource.

Just when universal bankruptcy was threatening all the commercial interests of England, Sir John Sinclair apparently woke up from a Rip

Van Winkle sleep and remembered the precedent of 1696, nearly one century before, when, says McLeod, "Montague had invented exchequer bills to sustain public credit, and [he, Sinclair] thought a similar plan might be followed in this crisis."¹ It was recognized that the lack of confidence was in the credit system, and not in a paper currency or in the values of good security. So a plan must be devised which will do away with credit and rest only on absolute values, or, in other words, make an appeal to a higher power and to an infallible credit.

The plan proposed by a Committee of the House of Commons and adopted by Parliament was that a Board of Commissioners should be appointed with power to issue, to approved applicants, a currency called commercial exchequer bills, to the extent of £5,000,000 sterling, for the payment of which the government was responsible. These bills were to be issued in making loans on property approved by the Board of Commissioners and pledged to and held by them as trustees for the note-holders until the loans were paid, and the exchequer bills canceled. This measure was a complete success.

The duties of the Board of Commissioners were almost identical with those of a loan committee of a modern clearing house, and the exchequer bills with clearing-house certificates, but the bills had the added advantage that they were a currency for

¹ McLeod's *Theory of Credit*, p. 733.

general circulation. This points to the development of clearing-house certificates into a clearing-house currency.

Sir Francis Baring writes thus of the effect of the commercial exchequer bills: "In a space of time scarcely credible, confidence was completely restored, money became plentiful, and the commission was terminated with a profit to the public after every expense had been defrayed." This has also been the experience of every issue of clearing-house certificates. "A small issue," continues Baring, "relieved the universal distress; only £2,100,000 were issued. A single drop of oil (and £2,100,000, when compared with the property and circulation of the country, is no more than a drop) withheld from the mainspring or pivot on which a great machine turns will disorder the whole."

It is instructive to note that John Wheateny, in his book entitled "Remarks on Currency and Commerce," London, 1803, says that in the panic of 1793 there were 1304 bankruptcies, and £3,000,000 of notes were contracted. So it would appear that Baring's "drop of oil" nearly equaled the notes contracted, and thus replaced a good part of the accommodation which had been curtailed by the panic. This is in confirmation of the principle that the power to control a panic must be equal to the money pressure caused by the panic.

Thus ended the panic of 1793. Baring asks, "Why not incorporate another bank in case the

Bank of England could not pay?" It was not, however, another bank that was wanted, but a cash system with the idea of credit eliminated. The support the credit system needs when it is tottering to its fall must come from a supply of cash or that which is as near as possible to cash. That was furnished by the commission which issued a government currency based on actual values held by the commission as trustees for the note-holders. The element of credit enters into a currency so issued about as little as it does in a metallic currency, which is accepted at its face value because it is stamped by the government at its intrinsic value. The principle is that when the credit system breaks down or is endangered, it can be fully supported only by actual cash, or by currency concerning which there is no doubt.

The credit currency or money, which has been contracted or destroyed, must be replaced by a cash currency which does not rest on credit. The coin of the government or paper currency with absolute security and ample guaranties behind it, then, is the only resource. Additional issues by banks, even if by the Bank of England, become of no avail at such a time. If the banks are independent, and each relies on its own reserves for solvency and are a "last resort," they must stand alone, and if one falls, the momentum is communicated to another, as if they were a row of bricks. Then it is that a trusteeship meets the emergency by the confidence it inspires by satisfying every one

that the currency issued thereunder is not based on credit but on actual property, and that the reasons for distrust in a credit currency do not apply to this. The commercial exchequer bills were no more than government notes loaned to private parties on security under the supervision of a board of control whose sagacity and faithfulness were above suspicion. A board so constituted and regulated could issue currency in any reasonable amount and grant all the accommodations wanted to satisfy the needs of all solvent borrowers.

This idea of a government board has appeared and reappeared in various forms from time to time before and since the panic of 1793, and apparently suggested by the success of that operation and its original in 1696. Notable among these suggestions is that made in 1842 during President Tyler's administration, of which Webster, then Secretary of State, was the chief advocate, if not the originator. The message presenting this plan to Congress was one of great power, and reflects credit on American statesmanship. It was a scheme by which a board of exchequer was to be appointed in connection with the Treasury Department with power to buy and sell exchange and to issue government notes for that and other commercial purposes, in effect making loans on acceptable collateral security to the extent of \$15,000,000. By this means Webster thought exchanges could be kept at moderate cost, or in other words the exchequer bills would be at par all over the country.

Webster said that the subject of currency had been the study of his life, and he had read everything of value that had been published on both sides of the Atlantic. It is therefore hardly possible that he did not get his exchequer plan from the panic of 1793. He said in his speech at Boston, September 30, 1842, "I believe the plan for an exchequer as presented to Congress at its last session [the 2d Session of the 27th Congress] is the *best* measure, the *only* measure for the adoption of Congress and the trial of the people. I am ready to stake my reputation that if this Whig Congress will take that measure and give it a fair trial, within three years it will be admitted by the whole American people to be the most beneficial measure of any sort ever adopted in this country, the Constitution only excepted." This would not be extravagant praise for a perfect banking system, and whenever that is constructed it will take its place alongside of the Constitution in its beneficent effects upon our country. But the desire to keep the government out of the banking business prevailed, and Webster's exchequer plan was never tried. For an emergency such a plan might work successfully in this country, as it did in England in 1696 and 1793, but as a continuous branch of the Treasury Department it would be too liable to abuse and consequent loss and scandal to the government.

The objections to the plan as a part of the government do not hold as against private enterprise,

and if the same operation was conducted through the agency of the banks as represented in the clearing houses, as has been done safely in the issue of clearing-house certificates, with the liability of the banks in place of the responsibility of the government, the plan would be free from objection and would accomplish all that Webster so confidently hoped from his plan for an exchequer.

A similar suggestion has been frequently made by less prominent persons. A book published in 1706, entitled "Discourse on a Land Bank," proposes a board of commissioners and directors to receive title to real estate and issue currency thereon, and that the "bills" thus issued "shall pass as the lawful coin of the kingdom." The principle of a trustee for the currency was sound, but the security was not suitable, which should be what is called "the liquidated wealth" of the country. This idea was no doubt taken from Montague's expedient employed in 1696.

William Blacker, London, 1839, in his book on "A Mixed Currency," etc., advocates an issue by commissioners appointed by Parliament of a national currency secured by mercantile paper, endorsed by the banks, which is sure to be withdrawn at the maturity thereof. "No paper," he says truly, "would remain in circulation beyond what was absolutely needed to carry on the commercial transactions of the country." "The existing laws force the Bank of England to sacrifice both mer-

chants and manufacturers for the preservation of its own existence." His proposition would provide a resource which would protect commercial credit.

In one of the tracts of McCulloch's collection entitled "Thoughts on the Currency," London, 1842, the writer proposes that commissioners shall be appointed by Parliament who shall issue a national currency. The commissioners were to divide the country into districts, so that all may have the benefits of the system.

John Wade, in his "Principles of Money," London, 1842, advocates a National Board of Circulation.

In a letter to Sir Robert Peel published in London, in 1848, the writer advocates "a properly constituted permanent board" to superintend issues of currency.

Edward Norton, London, 1867, in his book entitled "National Finance and Currency," proposes the creation of a "Council of Finance of the highest construction," of twenty-one members, from the Chancellor of the Exchequer down to a humble merchant, which council should have power to issue currency and hold securities as collateral therefor.

H. Bowlby Willson, London, 1874, would create a Currency Board, but does not work out the plan.

The issue of clearing-house certificates in this country, which experience has shown to be correct in principle and safe and effective in practice, is based on the same idea as were the exchequer bills

of 1696 and 1793,—that when the credit system breaks down it must be supported by a currency of undoubted credit that will be accepted everywhere as cash, and to be effective the support must be equal to the strain.

It was chiefly in view of the panic of 1793 and the suspension of 1797, that the Parliamentary Commission was appointed from whom emanated the celebrated Bullion Report of 1810. The mode of dealing with panics which they laid down was that “an enlarged accommodation is the true remedy for that occasional failure of confidence to which our system of paper credit is unavoidably exposed.” This is the evident and natural deduction from the success of the issue of an undoubted currency, amply secured by values in the hands of trustees, who in 1793 were the Parliamentary Board of Commissioners. But the Bullion Report laid the chief emphasis on the “enlarged accommodation” and not on the appeal from the credit system to a cash system.

It is almost a platitude in these days to say that an enlarged accommodation is the remedy for a panic, but it was not so at the time it was said by the Bullion Committee.

But it is another step in the development of the diagnosis to say that when the credit system breaks down, it should be protected and supported by an appeal to a higher system possessing a stronger credit. An enlarged accommodation could not be given by banks operating under the credit system,

for that would be in a state of collapse. Notes issued by the credit banks would be immediately returned. Professor Sumner, in commenting on this passage, said: "The rule of the Bullion Committee contemplated the loan of notes . . . whose credit cannot fail in the wildest panic." The Bullion Report did not say how they were to be issued; they only commended their issue. The plan of a currency issued by trustees who should hold the security for the notes was not discussed in their report.

The lessons of the panic of 1793 were therefore: —

First. An enlarged accommodation is the true remedy for a panic.

Second. The amount of the accommodation must be sufficient to meet and overcome the money pressure.

Third. The credit of the notes issued must be good in the wildest panic.

From the panic of 1793 we start on our progress down through the century of panics. A system of individual, unsupported, multiple banks in England and America went crashing on its way like a huge behemoth over cultivated fields, leaving destruction and disaster in its path. Since 1793 panics have occurred in the following years: 1797, 1811, 1813, 1816, 1819, 1825, 1837, 1847, 1857, 1866, 1873, 1884, 1890, and 1893. The true name for a system with this record is the panic system.

A distinction must be made between monetary panics, which come from a lack of confidence in the credit system, and commercial panics, which are caused by unfortunate speculations. These last are limited in their cause, area, and effect, while the former are universal.

A monetary panic is the result of a lack of confidence in the credit system when accompanied by a low state of cash reserves. A panic cannot occur with a high state of reserves. A low state of reserves is usually caused by some alarming event. Statements of the condition of the Bank of England prove this, but they were rarely published until recent years. From statements submitted to Parliament the following information regarding its reserves is gathered. In 1696 the currency famine reduced the reserve of the Bank of England so that on November 10, 1696, it was 2.151 per cent. of its obligations, and the result was a suspension of specie payments. In 1797 the war with France reduced the cash reserve to 7.887 per cent. of its obligations, and the suspension followed which lasted for 26 years. In 1825 the locking up of money in unproductive enterprises caused a demand which reduced the bank's reserve to 4 per cent., and the panic of that year followed.

Lord Ashburton, writing in 1847 of this panic, said, "The gold of the bank was drained to within a very few thousand pounds, for although the public returns showed a result rather less

scandalous, a certain Saturday night closed with nothing worth mentioning remaining."

J. Laurie Murray in a letter (1847) to Charles Wood, then Chancellor of the Exchequer, said, "The present [1847] is not a bullion panic, but one founded on the reduced amount of the reserve, and the inability of the bank to aid the public."

In 1857 the depreciation of railway investments caused a demand for cash which reduced the Bank's reserve to 1.927 per cent. of its notes and deposits, and the panic of that year was the necessary sequence. These reserves were "miserably low" in themselves, but still more so when it is remembered that the Bank of England holds the reserves for the entire English nation.

The Parliamentary Commission of 1857, appointed to examine into the panic of that year, brought in a recommendation that "new provision be made in advance for such contingencies [as panics] and the conditions be expressly laid down on which the issue of an increased number of bank notes may in the time of pressure be allowed." This is such a plain and sensible suggestion, it would seem surprising that Parliament has never acted on it.

Each one of the fourteen or more panics which occurred between 1793 and 1893 may be taken up by itself and examined, and the deductions therefrom will always be the same as in the first panic of 1793. If the credit banks had not been a *dernier ressort*, if a source had been in existence

established by law for the issue of a solid currency, and the loan thereof to solvent parties, to an amount equal to the money pressure, all this dreadful list of panics with their untold miseries, so far as they were caused by currency famines,—and that was their chief cause,—could have been avoided.

Every monetary panic necessitates the closing of many business transactions, the cancellation of an equal amount of credit, and a consequent diminution of the amount of money in the hands of the business community, or for which they can draw. It is on the regularity and stability of this supply of credit money that the successful prosecution of business depends.

English bankers and financial writers are now fully aware of the weakness of their bank reserves when compared with the strain to which they are liable. Their dependence on loans from the Bank of France is humiliating. A writer in the "*Quarterly Review*" for July, 1899, asks, "Has the Bank of England ever been in a position to render a reciprocal service? Could it even at any ordinary time have lent the Bank of France three millions sterling?" This is the amount borrowed by the Bank of England from the Bank of France during the Baring panic.

We naturally ask why a remedy for panics has not been found in England and America as it has been in France and Germany. The Imperial Bank of Germany, since 1875, has had the power

to issue notes without limit. Its connection with the government and its virtual monopoly makes this currency of undoubted credit. So in France, the Bank of France carries the enormous reserve of over \$600,000,000 in gold and silver with which it is free to support the banks of France. Consequently in France and Germany they do not have panics.

We ask, Why do we not in England and America adopt similar methods, and thus stay the ravages of panics? The answer in part is because high authorities like David Ricardo have held that "against a general panic, banks have no security under any system," and this opinion has been accepted as indisputable by the Anglo-Saxon business community generally. Ricardo instead of bewailing that there is no security should have set to work to make one. He had the example of the Act of Parliament in 1793 to guide him in the right way to secure that end. But his dogmatic assertion beclouded his mind and led him astray and all his followers with him.

The answer also in part is that the Anglo-Saxon will not permit a monopoly, and it has seemed to our lawmakers that no method has yet been proposed to grant the power of issue of a higher grade of currency without granting a monopoly as well. Independence and self-reliance are innate in Anglo-Saxon blood, and the evils of panics are endured rather than surrender these bulwarks of liberty. It is evident, however, that the incorpo-

ration of clearing houses under a general federal law, with power to support the credit system with a trustee currency, would be in harmony with our institutions and would afford the protection needed. This currency would be similar to the issue of exchequer bills by Montague in 1696, and identical with those issued by the Parliamentary Commission in 1793. The mode of issue has been successfully practiced in a limited way by the New York Clearing House for about forty years, and by many other clearing houses in other cities for a lesser time. Having been successfully operated for one hundred years, may it not be permissible now to say that it is no longer an experiment?

We are entering upon a third century in the history of the credit system. Will it also be a century of panics, or will an intelligent plan be adopted in England and America by which these evils will be mitigated if not entirely avoided by providing an efficient support to the credit system? The result would be to protect the business community from sudden diminution of the credit money of the country, which is the cause of monetary panics.

The credit system began two centuries ago to try to do business on a reserve of two per cent. The latest national banking system is that of Germany, which in effect provides a reserve of one hundred per cent. Thus the progress has been towards stability. Let us hope that the 56th Congress will legislate in the same direction.

VI

A FINANCIAL OBJECT LESSON FROM THE WAR WITH SPAIN

Part I. The Forecast

THE possibility of a war with Spain has led our government to examine into the condition of our army and navy to ascertain what is needed to place these departments on a war footing, and a similar inquiry should be made in regard to our banking system.

The country has been startled to learn how much needs to be done to enable this country to cope even with a third-rate power. Congress is promptly meeting the emergency by authorizing the expenditures called for by the army and navy, and in the same spirit laws should be enacted to reform our banking system so that it may be able to protect commerce and sustain values even in the face of a declaration of war. The strengthening of our banking system is even a more important matter than the preparations for the defense of our coast line bordered with rich cities, because it affects the entire country, with its estimated \$60,000,000,000 of property. The defense of values and of commerce is the work and duty of our

banking system alone; and if we are sure that it has power to meet all shocks, even that of the declaration of war, then one of our great sources of anxiety, if not the greatest, will be removed.

Money is the sinews of war, and if those sinews are paralyzed the combatant is handicapped at the start. We all know that war would impose a burden on our banks which they could bear only with the greatest difficulty. From our experiences in the last few years we lack confidence in the ability of our banking system to sustain the country in an emergency, and we anticipate that a declaration of war would be followed by a panic in all markets, both financial and commercial.

CALLING BACK GOLD FROM EUROPE

To strengthen themselves against these chances of war our banks are now calling gold back from Europe, just as they did in 1860 and 1861, and later in 1873 and in 1893 and at other times, but in none of those instances was the amount of imported gold sufficient to ward off disaster, nor is it sufficient at the present time to protect the vast obligations of New York to the rest of the country if war is declared. A glance at the situation reveals this. The deposits of New York banks are, in round numbers, \$680,000,000. They hold a reserve above legal requirements of about \$30,000,000 gold. This is 4.4 per cent. of their deposits, and if that small percentage should be called for by depositors the banks of New York

would be powerless to assist the country or to pay to country banks their deposit reserves, which form a large part of the remaining cash reserves.

The amount of gold now being imported seems large, in itself considered; but when compared to the total deposits of New York banks it dwindles to only another 4.4 per cent.; and by the time it arrives, if war should be declared, it will all be wanted by correspondents all over the country, and will have disappeared.

The importations of gold should be looked after principally with reference to the needs of the entire country, of which New York is the representative. Compared with the \$3,000,000,000 to \$4,000,000,000 of banking deposits of the country, the inadequacy of importation of gold to relieve stringency, meet demands of depositors, and support commercial credit becomes at once apparent. This statement is sufficient to establish the correctness of the conclusion that gold importations are an inadequate resource, and we have also experience of the results of importations of gold in previous years, all of which should convince even the firmest believer in this method of giving stability to our finances that it is insufficient.

Not only are the banks of New York in a condition unprotected against sudden failures of confidence, but an examination of cash reserves shows that all the banks of our country are in a similar condition. The thirty-four hundred country

national banks hold cash reserves of only about fifteen per cent. of their deposits. The eighty-two hundred national, state, and private banks, comprising all the commercial banks of the country, hold less than twenty per cent. of cash as a reserve.

TWO DANGEROUS FEATURES

These reserves are small in themselves, and there are two features of our banking system which make them specially dangerous to the commerce and property of the citizens of the United States. One is that this is all the cash reserves which the banks have, and there is no provision in the banking laws for any further protection to commerce and credit, except by forcing liquidations; and the second is that when a slight decline in the reserve takes place the National Banking Act forbids any fresh discounts until the reserve is restored, and if that is not accomplished in thirty days a receiver may be appointed for the delinquent bank. The passing over this dead-line inaugurates a panic.

These features of the banking system of our country make it peculiarly liable to panics and spasms of apprehension. The question is, What would be the effect on our country with such a banking system if a declaration of war were made? Even the expectation of a declaration of war is a signal of a disturbance which causes untold losses of property. Banks cannot support business, but are obliged to take care of themselves and augment

their small reserves as best they can by competing with each other for the floating cash.

The first effect of a declaration of war would therefore be the infliction of a great catastrophe on our own people. This condition of affairs is caused not so much by the smallness of the reserves as by the fact that there is no provision in our banking system for the protection of banking and commercial credit when reserves are impaired. Our reserves are sufficient for ordinary times, but they are not sufficient for emergencies.

This difficulty can be cured in the simplest manner by, first, the incorporation of our clearing houses under a federal law; and, second, by giving to at least one in each State the power to issue a clearing-house currency on pledge of bank assets at seventy-five per cent of their value to any bank member, the currency to be good at any clearing house.

A CREDIT CURRENCY ISSUE

That a provision by law for the issue of a credit currency will accomplish the object of giving stability to a nation's commerce under stress of panicky conditions is shown by the example of Germany, whose banking law confers the power of issue on a few of its largest banks. This law has prevented panics in that nation for over twenty years. A similar law in our country would do the same for us.

While the possibility of a war is before us it

behooves our legislators to reform our banking system to make it strong enough to withstand the shock which a declaration of war would give.

It would be folly to provide a navy of wooden ships, and therefore we build or buy only armored vessels. We make the thickness of the plates to correspond to the weight and power of modern projectiles. We build forts with solid earthen embankments, so that nothing can throw them down. Old-fashioned wooden ships and brick forts may be compared to our present banking system. They would go down before the first attack, and the worst defeat of any war we might engage in would be when our commerce would be prostrated at the first assault on our banking system following the act of our own government in declaring war. The banking system is the only protection for all the property of our country, and the instant necessity for placing it on a war footing should be recognized by all business men.

No change in our national banking law is required, only the passage of a bill, like the one now before Congress, incorporating clearing houses, and giving them the power to issue a safe credit currency to protect and support commercial credit. This would modernize our banking system and make it an efficient support to the government in its preparation for war, and a protection to the people if that event should come to pass.

March 19, 1898.

Part II. The Retrospect

Whether the late financial disturbance occasioned by the war with Spain ever rose to the dignity of a first-class panic may be doubted. It is relatively as short of attaining that importance as the war is of being a first-class war. The apprehension which many felt at the period of the greatest depression, which culminated during the last ten days of March, was happily disappointed in the early discovery, as the weeks passed by, that our opponent was not as we supposed a foeman worthy of our steel, but a "decrepit gentlemanly roué," whom it was a regrettable, rather than a difficult, task for a young athlete like the United States to be obliged to knock into insensibility.

The feeling of apprehension having now subsided, and the financial disturbance caused by the war being about over, its stages and effects can be critically examined, and remedies to enable the business community to bear similar strains with greater ease may be profitably discussed.

The war has taught us the necessity of raising our army and navy to a higher state of efficiency, and it has its lesson also in the same direction for the financial world.

The spasm may be divided into its acute and chronic phases. The sinking of the *Maine* took place on the 15th of February. The acute condition culminated during the last ten days of March, when stocks declined from 10 to 20 per cent., good

bonds from 5 to 10 per cent., and money rose to sharp 6 per cent. for all dates in New York, and to $7\frac{1}{2}$ or more at other centres, and was practically not to be had. The chronic condition culminated on the 30th of April, when deposits of New York banks reached their lowest point and began to increase, and when rates for money on call fell to 2 per cent. again.

Up to the 15th of February, the banks of New York had been loaning and investing freely, and their deposits then stood at the high figure of \$738,600,000, but their surplus reserve above legal requirements was only \$32,400,000, or 4.4 per cent. of deposits. This must be recognized as a weak condition, unless the banks had other resources besides their cash to meet demands from depositors.

They had two resources, and both were at the expense of the commercial community. One was the importation of gold, with all the derangement of the foreign exchange market and restriction of importations which followed and may continue for months to come. The other was the cessation of discounts and calling of loans with the forced liquidations and losses which that involves.

From the 11th of February to the 30th of April the importations of gold at New York were \$58,000,000, but this amount and \$8,000,000 more from the lawful money reserve was absorbed by the demand for currency from out of town banks and for hoarding purposes. The lawful money

reserve was reduced from \$217,000,000 to \$209,130,000.

During the same time loans decreased \$69,600,000. So in this short time we see there was a diminution of business which must at least be equal to the importations of gold and the reduction of the lawful money reserve and of loans, added together, or \$135,500,000.

This action of the banks was a central impulse which set in motion a series of liquidations in widening concentric circles, until the whole business community was affected. Merchants, brokers, commission houses, dealers, and manufacturers, all felt the restriction, and in some instances even the laborer was reached.

There was a still larger restriction of business from the checking of enterprises of which the contraction of banking facilities was only the surface indication. Thus a greater loss was self-inflicted on the business of the country than has resulted from any other event of the war. The demand for currency was entirely for home use, and might have been met and satisfied by a sound credit currency issued by the banks.

During the same time, there was a reduction in deposits of \$80,000,000; and as the reduction in lawful money reserve was only \$8,000,000, a rise resulted in the percentage of the surplus reserve from 4.4 to 6.75 per cent. of deposits. This still was not a strong position for banks under a competitive system; but the weakness of Spain had

meanwhile become apparent, and public confidence in the able management of affairs by President McKinley and in the patriotism of Congress, and in the success of our army and navy, had so increased, that anxiety was well-nigh entirely removed. So the state of affairs, in a word, was that up to the 15th of February all the banks were encouraging the business community to borrow money and were lending up to and some would say beyond the limits of prudence, and then for two months and a half thereafter they stopped lending and discounting, and withdrew banking facilities from the general public. So it came to pass that the banks forced liquidations on the very parties they had before been encouraging to borrow, to an amount which may be estimated at \$135,500,000.

It is evident that the banks did not bear any part of the loss of this liquidation ; the whole burden was thrown on the mercantile community. At the very time the best investment stocks had declined ten per cent. or more, the stock of one of our New York banks sold at an advance of ten per cent. above any previous sale.

The banks, having, at the present time, recovered from their apprehension, they are again beginning the old routine of encouraging borrowers to take money by offering it at low rates on call, and are competing with each other for the best paper at a less discount than they have been willing to accept for two months and a half. The

process of bank expansion and contraction seems destined to repeat itself. The banks will foster business until it becomes active and apparently prosperous, and when some other cause for alarm occurs, say the fall elections or an active business, then they will again compel liquidations and again throw the whole burden of the losses thereof on the mercantile community.

If we look back on the history of monetary affairs, we see that this alternation of bank expansion and bank contraction has been going on in this country and in England with little intermission for generation after generation, and it has always been at the expense of the business community and for the protection of the banks.

But in France and Germany bank rates of interest seldom change, and they do not have monetary panics. The explanation is that in those countries they have systems of graded banks, and when a "run" occurs, the commercial or popular banks do not turn on their borrowers to force liquidation and disaster on them, but they turn for assistance to a higher grade of banks, to whom is given the exclusive power to issue a credit currency. The contention herein maintained is that we can protect commercial credit in our country with a certainty equal to that attained in France and Germany, by incorporating our clearing houses under a federal law, as proposed in Bill H. R. No. 9279, Fifty-fifth Congress, Second Session, and by giving to at least one in each State the

power to issue credit currency on pledge of bank assets.

This measure would protect commercial credit and the business community from the largest part, if not all, of the losses occasioned by forced liquidations under our present "evil and misguided system." It would substitute the clearing house in the place of the business community, as the resource of the banks for their protection. It would make our banking system strong enough to withstand even the assault of war without serious disturbance.

Our banking system is like a bridge which is not sufficiently strong to carry any but a light traffic. If a heavy strain is put upon it, it will break down. The resource which is employed to protect it is to dump the surplus passengers and freight into the river. Would it not be better to strengthen the piers and superstructure so that there will be a margin of safety above any strain to which the bridge can be subjected from either traffic or elements? It is not a great cause for congratulation, after a narrow escape from a disaster such as was feared from the Spanish war, to learn that this time the old bridge stood, and only a few of the passengers and a small part of the freight had to be thrown into the river.

Causes for every panic may easily be found, and it seems to many that if this or that thing had been done by banks or leading financial men, any given panic might have been avoided. If the

silver men had not made their campaign we should not have had the silver panic. If the Venezuela message had not been written we should not have had the Venezuela panic.

But we must expect every now and then startling events of sufficient power to shake confidence. We must expect unwise action by unwise men ; we must expect unlooked-for disasters, wars and trouble of all sorts. We must expect errors of judgment among business men, infatuations and bubbles.

These are all permanent factors in the problem. The question is, How does our banking system act under the stress produced by such circumstances ? It is not whether the disturbance was of larger or smaller dimensions, or whether if this or that event had or had not happened, the disturbance might have been avoided or lessened, but it is, What is the action of our banking system when a disturbance takes place of sufficient magnitude to impair confidence ? Is the banking system at such a time a support to commercial credit or does it destroy it ? Does it defend or attack the business community ? Is there coöperation or antagonism between the banks and the people ? Do the banks consider the people fair game at such times ? Are they at peace or at variance with one another ? The words of Nathan Appleton of Boston answer the question when he said, " But these alternatives of bank expansions and nominal prosperity, followed by bank contraction, disappointments and

perhaps failures, are very much to be deprecated. The banks, to be sure, have no difficulty in these cases if well managed; the whole pressure is thrown on the mercantile community." Samuel Hooper, a merchant of Boston, formerly a member of the House of Representatives, expressed the same opinion as follows: "No blame should be imputed to the banks or their directors for the inconvenience and distress caused. They have only consulted the interests of the banks. In doing so they were true to the system. The interest of the bank is at variance with the public interest. The customers of the bank sustain the loss while the banks have had the profit."

An examination of the developments during the financial disturbance caused by the present war with Spain shows that it is like all previous panics. The whole burden was thrown on the mercantile community, and the interests of the banks were at variance with the interests of the people. Should not this wrong be righted? It can easily be done by incorporating clearing houses under a federal law, giving them special functions and rights not enjoyed by commercial banks, and conferring upon at least one in each State the power to issue currency to banks on pledge of bank assets as collateral. This will form our banks into a system, which will protect the credit of both banks and the commercial community, prevent or largely mitigate panics, and establish coöperation between the banks and the people.

VII

VARIANCE OF INTEREST BETWEEN THE BANKS AND THE PUBLIC

IN the issue of the "New York Evening Post" of the 11th inst., May, 1898, in commenting on the book entitled "A Graded Banking System" the writer says that the author apparently supposes "that bankers are indifferent to the solvency of the people whose notes they discount." A careful reading of the paragraph preceding the one quoted does not sustain this inference. Not only to set the matter right with the readers of that valuable paper, but to call attention to what seems to be almost a forgotten aspect of our banking system, composed as it is of individual banks of equal grade, a few words must be said in explanation of the statements referred to.

Let us begin with the provision of the National Bank Act, chapter 5, section 95, that whenever the reserves of a bank fall below the legal requirement, it shall not make any new loans or discounts until its reserves are restored, and if after thirty days it shall fail to make them good, a receiver may be appointed to wind up its business.

This is a simple regulation. It is addressed to

each individual bank, and instructs each separately to make good its reserves, if by chance they fall below what the law regards as a prudent percentage, by calling in loans and refusing to renew discounts. The theory is that the outside public is a reservoir, from which each bank may with propriety draw cash to repair its reserves. The law thus constitutes an individual bank as the unit for the system, and having made the regulation for the government of the unit in protecting its reserve, it forms the system by multiplying the unit three or four thousand times.

The system thus formed in its nature is a competitive system. It has within it all the material for a bank crisis; for whenever a general effort to restore reserves is made at the same time by all the banks, banking facilities as a necessary consequence are withdrawn all over the country, and great distress is occasioned to the business community. If complaint is made of the action of the banks, their reply is that they are only complying with the law, and that while they regret exceedingly to cause any disturbance, there is no other way provided in the law by which they can protect themselves. This is a perfect answer, and it quiets the consciences of bank officers even when they see and know that their acts cause widespread distress. They do not feel indifference, but a kind of complacency or serenity that comes from the performance of strictly legal action, which, while it benefits the bank, at the same time hurts the community.

This one-sided operation has been commented on by many authorities on banking. Samuel Hooper, a merchant of Boston, formerly a member of the House of Representatives, in his book on "Currency and Money," says that this is a process "which invigorates the currency at the expense of the industry and enterprise of the country." He quotes Hon. Nathan Appleton of Boston as saying: "But these alternatives of bank expansions and nominal prosperity, followed by bank contraction, disappointments, and perhaps failures, are very much to be deprecated. The banks, to be sure, have no difficulty in these cases, if well managed; the whole pressure is thrown on the mercantile community." Mr. Hooper continues: "No blame should be imputed to the banks or their directors for the inconvenience and distress caused. They have only consulted the interests of the banks. In doing so they were true to the system. The interest of the bank is at variance with the public interest. The customers of the bank sustain the loss, while the banks have had the profit."

The truth of these words is shown in every panic. After a while, perhaps, business men will begin to get at the true definition of the word "panic," which is a sacrifice of commercial interests to support the banking system. Is there not a cheaper way to secure this most desirable and essential support?

The contention in the book under discussion is well epitomized as follows, — that there should be

a clearing house incorporated in every State, by a national law, which should issue currency to banks on pledge of their assets as collateral. The object of this is to make the banks sustain their customers as well as derive a profit from them. They would do this by turning to the clearing house to find a remedy for a bank crisis instead of throwing the whole pressure on the mercantile community, — to use the words of Nathan Appleton. The result is that coöperation is thus established, which prevents the interests of the banks from being at variance with the interests of the people.

VIII

RELIEF FOR THE BANKS

AFTER a pestilence in a city the authorities can generally be induced to study modern methods for the disposal of sewage. Loss of property and of life seems necessary to awaken a community to consider the recommendations of experts or to move a corporation to change from old methods to new. All remember the cost of life and property needed to secure the abandonment of side wheels on ocean steamers, and many expensive reforms in railroading are due to equally dreadful disasters.

The great loss of property resulting from the defects of our banking system should be the incentive to similar reforms, and it is opportune at the present time [August, 1896] to point out those defects while they are causing losses and deranging the business of the country. In a time of disturbance men do not turn lightly away from the consideration of measures of relief.

The defect of our banking system is that a forced liquidation is the only way provided by law for the restoration of depleted bank reserves.

The national banking law requires a specified percentage of reserve to be maintained, but by

redeposit the actual amount of cash reserves is much reduced from that percentage. The banks, therefore, are allowed by law to do business on their credit, and to owe four or five times as much as the amount of cash on hand. But when they are called on for their reserves, or any part of them, the law makes no provision by which they may restore or protect them except by forcing liquidations on the business community. Forced liquidation means disaster. It catches the community on a sudden and compels them to sell out their property at a sacrifice to raise money to restore the reserves of the banks. This causes great declines of all values and many troubles both known and unknown. It stops business and wages, and all for the sole purpose of restoring the reserves of the banks.

It stands to reason that a system of banking is defective which works in this way. It is the credit system for the banks and a cash system for their borrowers. And our banks are running on such a small margin of reserves that the business community is at all times in danger of being called upon unawares to liquidate, to help the banks out. After losses have been incurred and depreciations have taken place to the extent of hundreds of millions, then the banks can resort to the extra-legal and extra-hazardous method of protecting themselves and helping out the survivors by trenching on their reserves, and issuing to themselves clearing-house certificates in place of reserves paid

out to meet cash demands. Before using this last resort the public has been pretty well squeezed.

In all these matters the banks are doing the very best they can for their customers and the business community, and are not open to any criticism or censure, for the blame is wholly and entirely on the existing system, and is due to its plain and easily remedied defects.

The remedy is that our banks should not only be conducted on the credit system as now, with authority to lend 75 per cent. of their depositors' money and retain 25 per cent. on hand as a cash reserve, but also, in case of need, should have some source from which they can obtain circulating notes, on pledge of their commercial assets, for a further percentage of their depositors' money, which, with the cash reserve of 25 per cent., would give them sufficient funds to liquidate as much of their deposits as might be demanded without forcing liquidations at frequently recurring intervals on the borrowers of the 75 per cent.

It is true that in ordinary times it is safe for banks to lend 75 per cent. of their depositors' money and to hold but 25 per cent. as a reserve; but to meet extraordinary events, like the Baring failure, or the panic of 1893, or the Venezuela message, or the silver scare, power should be lodged somewhere by which the banks could obtain sound credit in the form of circulating notes to liquidate the 75 per cent., or a sufficient percentage thereof to carry them over the extraordinary

crises to quieter times without calling upon the borrowers of the 75 per cent. to make forced liquidations and great losses to accomplish the same object. It is evident that if the banks could obtain sound credit in the form of circulating notes, the liquidation would be accomplished without loss to themselves or the business community.

A knowledge that the banks had this power to protect their reserves in this way would allay if not prevent panics.

This is the system of the Bank of France and of the Imperial Bank of Germany. During the twenty-five years in which this system has been in operation in Germany it has been tested many times by serious financial disturbances, and has carried the business community of that nation safely through them all. A French bank will advertise its condition, showing 10 per cent. of its liabilities in cash, 10 per cent. in call loans, and 50 per cent. in bills receivable "immediately discountable at the Bank of France." Such a showing is impregnable.

The same end can be attained in our country by incorporating our clearing houses under United States laws, with power under suitable restrictions to issue a clearing-house currency to their members. This idea has been elaborated in the bill H. R. 3338, which was introduced in the House of Representatives, January 6th, 1896, by the Honorable Benjamin S. Fairchild, and in explanation of which a statement was before a sub-committee

of the House Committee on Banking and Currency in February, both of which documents were published in "The Banking Law Journal" of March, 1896.

Any circulating notes issued to banks must be of a credit so undoubted as to be accepted by all banks in any panic. This credit can be reached by the supervision of the associated banks, and this supervision by the incorporation of clearing houses under United States laws.

Now, since it has occurred that the party friendly to silver and hostile to national banks has been defeated in the general election of 1896, the completion of the national banking system in harmony with American institutions becomes a practical and pressing question. A good tariff will protect the finances of the general government, and easily maintain all its obligations on a par with gold. A sound banking system will give stability to our commerce and protection to the credit of the business community. These two measures should mark the advent of the present administration [1897-1901] in which all branches of the government are controlled by one political party.

IX

WHAT IS AN ELASTIC CURRENCY?

THE editorial in the "New York Tribune" of the 6th January, 1899, entitled "An Elastic Currency," states well the argument in favor of our present system, and invites a reply by asking, "What do people mean by an elastic currency?" The advocates of such a currency should be prepared to answer a question put so fairly and clearly.

The subject can best be explained by an example; and as the facts of the financial situation in 1893 are now well known through the reports of the comptroller of the currency and from other sources, we may accept them as substantially correct, and use them for illustration.

The financial bridge broke down in 1893, as it has broken down before and since. The explanation of the breakdown is that the bridge was not able to bear the strain. There are two ways of obviating these accidents. One is the old-fashioned way, not to allow the teams to go faster than a walk, and the other is to make the bridge so strong that a loaded express train can go at full speed over it without causing any deflection.

Modern business requires solid construction, and that is the end aimed at in this discussion.

The facts of the breakdown in 1893 are as follows: The deposits of all national banks in the country on December 9, 1892, and October 3, 1893, were as follows:—

December 9, 1892	\$1,764,456,177
October 3, 1893	<u>1,451,124,331</u>

The shrinkage between these two dates was therefore	\$313,331,846
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Other commercial banks, state and private, probably suffered a similar shrinkage, and as their deposits are about one half those of national banks, the total shrinkage in banking deposits throughout the country during the period named was about \$400,000,000. This represents the money pressure on the banks caused by withdrawals, hoarding, etc. The only resource the banks have for meeting demands upon them without diminishing their reserves below legal requirements, or calling loans and refusing discounts, and thus causing forced liquidations, is by expanding their national bank currency. Let us see how much relief was obtained by this means. During the period which we are examining the national bank notes were increased as follows:—

Amount outstanding October 1, 1893 . . .	\$208,592,172
Amount outstanding December 1, 1892 . . .	<u>173,510,828</u>

The increase of the national bank notes under a \$400,000,000 money pressure there- fore was	\$35,081,344
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or slightly less than 10 per cent. of the amount needed to prevent the panic.

Consequently the banks were obliged to issue clearing-house certificates and have recourse on their assets to raise the balance of the money.

The liquidation which was thus forced on the business community by the national banks is shown by the following figures. Their loans and discounts were, on the following dates : —

December 9, 1892	\$2,166,615,725
October 3, 1893	1,843,634,167

The amount of liquidation which was thus forced on the business community during the time named by the national banks was \$322,981,558.

A corresponding liquidation was made by other commercial banks, bringing the total stoppage of business up to about \$400,000,000. The disastrous consequences of this liquidation have been felt for years. The total failures for the years 1892 and 1893, as given in “Dun’s Review,” were as follows : —

Year.	No. of failures.	Amount of liabilities.
1892	10,344	\$114,044,167
1893	15,242	346,779,889
Increase in 1893		4,898 \$232,735,722

These failures and liabilities represent the financial troubles and losses that came to the surface. The losses that were borne without publicity would increase the amount largely.

What is the inference? It is that our present system affords our business community less than one tenth of the protection from panic which it needs. In other words, under a tremendous money pressure the currency has one tenth of the elasticity it should have. There was an unused currency privilege on government bonds at the same time of \$427,000,000, but the banks did not own and could not acquire the bonds necessary to avail themselves of it. There was a similar state of affairs in 1873 and in all the minor panics. Does not this prove that our present system is inelastic?

If a man-of-war were required to pass a speed test of twenty miles an hour, and under forced draught could go only two miles, would it not be condemned as having no speed? If a projectile were required to pierce ten inches of armor-plate and could pierce it only one inch and then shatter, would not that be called a lack of piercing power? If all the departments of the army and navy were at only one tenth of required efficiency, in what shape would the country be to resist the attack of a foreign power? That is the position of our banking system to-day. It has less than one tenth of the elasticity necessary to ward off a panic.

The principle of elasticity may be formulated as follows: If the mode of supplying bank currency is by notes issued on special classes of assets, then the elasticity of the currency will be just in the proportion which those special assets

bear to the total liabilities of the banks. Or it might be limited somewhat as follows: That the elasticity of a currency so issued would be in the proportion which those special assets bear to the amount of money needed to insure solvency under any and all circumstances.

The article closes as follows: "If this [the present currency] is not the most elastic currency conceivable, pray, what banker can suggest any form of circulation which will be as elastic, as responsive to the needs of business and in the light of experience equally safe?"

What has just been said is intended to prove that our present currency has only one tenth of required elasticity, and an answer is needed to the last part of the question only.

The banks of the city of New York associated in the New York Clearing House for the last forty years, and other banks in other clearing houses, for a lesser time, have suggested in their clearing-house certificates a form of currency to give relief to the business community in time of panic. The basis of this currency is any of the acceptable assets of the banks, and consequently it has all the elasticity to be obtained from absence of limitation to a special class of assets. No money has ever been lost on clearing-house certificates, and "in the light of experience" they are equally safe with national bank notes. They are also responsive to the demands of business.

Clearing-house methods need only to be legal-

ized by the incorporation of clearing houses under a federal law, so that they can do legally that which for forty years they have successfully done extra-legally, in order to carry this suggestion into practical effect. One clearing house of issue might safely be established in each State, so that the business of all the country could receive equal protection. The issues should be in the form of currency to be circulated as money, and then our banks would be in position to meet demands for currency without forcing liquidations on the commercial community.

Not only has this suggestion the recommendation of a favorable business experience for forty years, but it is approved by some of the ablest of the scientific monetary experts in this country.

The need of elasticity and the way to get it may be taken as the theme of "The Theory of Credit," a work by McLeod, the foremost English authority on banking and currency. He states his fundamental principle thus: "In the modern system of credit it is indispensably necessary that there should be some source to create and issue solid credit to sustain solvent houses in a monetary panic."

It is the sad experience of our business men that we have no such source in this country in any way adequate to our needs; but the opinion is gaining ground that the incorporation of our clearing houses under a federal law, with power to issue an emergency currency, would give it to us.

X

CLEARING-HOUSE CURRENCY EXPLAINED AND DEFENDED

IN the article entitled "Elasticity in the Currency" in "Sound Money" for February, 1899, the writer says: "There is nothing to prevent the banks in any State which have formed a clearing house from doing just what the New York banks did in 1893, and if they did not do so it was probably because they hesitated to trust each other. If Mr. Gilman's plan of legalized clearing houses had been in operation in 1893 in such States as Kansas, Nebraska, and Alabama, there would have been a flood of certificates issued against titles to land enormously overvalued."

An explanation is needed to endeavor to remove any misapprehensions which the brevity of the letter to the "New York Tribune," on which the above quoted comments are based, may have occasioned.

CLEARING-HOUSE CERTIFICATES AND CLEARING- HOUSE CURRENCY COMPARED

First, the distinction must be perceived between clearing-house certificates and clearing-house cur-

rency. The certificates are a currency only between the bank members of the clearing house which issues them, while the clearing-house currency would be circulated as money between banks and their creditors and also throughout the community. Clearing-house certificates take the place in the vaults of the banks of their lawful money reserves which they have paid out, while clearing-house currency would be paid out by the banks to meet demands on them, and thus they would be enabled to hold their lawful money reserves undiminished. A bank creditor at the clearing house must take its proportion of the certificates instead of cash, and therefore every issue of certificates diminishes the amount of cash held by the banks in the clearing house, and weakens their position to that extent. Even in the largest clearing houses, the amount of certificates which can be issued is limited by the amount of cash which can be spared, and that is small when compared with the demand which arises in a panic.

SAMUEL J. TILDEN ON THE INSUFFICIENCY OF CLEARING-HOUSE CERTIFICATES

Samuel J. Tilden alluded to the insufficiency of clearing-house certificates to control the panic of 1873, in his first annual message to the Legislature of New York in 1875. He said: "It is idle to pronounce the machinery of credit a maniac and then to put only its little finger in a strait-jacket." That is, clearing-house certificates are no more

able to control a panic than holding his little finger would enable one to subdue a maniac.

This was said by Mr. Tilden when the panic of 1873 was fresh in the minds of all. It is a self-evident proposition that the power to control a panic must be greater than the power possessed by the panic. But it is wiser to give a prophylactic to the financial patient, well compared by Mr. Tilden to a maniac, and thus ward off the paroxysm entirely, than to wait until the fit is on and then endeavor to control it by heroic measures. Clearing-house certificates are by their nature remedial and not preventive. They are a last resource in a panic. They are like a strait-jacket after a patient has become excited. Clearing-house currency by its nature is preventive.

CLEARING-HOUSE CERTIFICATES DANGEROUS TO INTERIOR BANKS

Then, again, clearing-house certificates cannot be issued with safety by interior clearing houses, for they would drain the banks of their lawful money reserves, which would not return to them, and the banks would be left in a weak and vulnerable position. Clearing-house currency, on the other hand, could be issued by interior clearing houses with entire freedom and safety, and the further it would go from home and the longer it stayed out, the greater the profit to the issuing bank. Such a currency would prevent panics by providing an ample supply of money as soon as

the need arose, and thus would produce stability at all times. It would be accepted by the public as the very embodiment of "Sound Money."

CLEARING-HOUSE CURRENCY PREVENTIVE OF
PANICS

Clearing-house currency would be authorized by law to circulate as money in the community. It would have all the safeguards which have proved so effective in connection with certificates, and be issued to banks on collateral at 75 per cent. of its valuation, and be received by all banks for all dues to them. It would thus be maintained at par from one end of the country to the other. The "maniac" could not have a paroxysm because the sedative would be administered before the appearance of the convulsion. The currency would be paid out and the lawful money reserves retained. Clearing-house currency would therefore be a protection to the banks and a source of strength, while we have seen that the certificates weaken the banks with every issue. So it appears that adequate elasticity would be provided by such currency, while the amount of elasticity afforded by certificates is entirely inadequate.

CLEARING-HOUSE CURRENCY SAFE IN WESTERN
STATES

The second sentence quoted above from the article under discussion expresses a fear that clearing-house currency issued in "such States as Kansas,

Nebraska, and Alabama" would not be well secured, and would be issued in excessive amounts.

These fears are quieted by an examination of the proposed bill incorporating clearing houses. The words describing the assets which may be pledged as collateral security to the issues of clearing-house currency are the same as those used in the National Bank Act, which limit the investments of national banks. "Titles to land enormously overvalued" are therefore excluded.

PROVISIONS SIMILAR TO THOSE OF OLD STATE BANK SYSTEMS

The proposed bill also limits the issues to the par of the capital of each bank. Therefore in States with small banking capital the issues would be small.

The proposed bill also makes the clearing houses of each State liable for any loss on the currency issued to banks in their State. This liability would tend to restrict issues within conservative limits. The contingency of losses sufficient to absorb the entire banking capital of a State, so that a loss would fall upon the clearing houses of other States, is provided for in the bill, but is too remote to call for much consideration.

Those who are familiar with the banking methods which prevailed a generation ago, will recognize that these provisions are similar to those of the old state banking systems.

CLEARING-HOUSE CURRENCY SAFE IN KANSAS,
NEBRASKA, AND ALABAMA

As the States of Kansas, Nebraska, and Alabama have been mentioned in the editorial under review, it may be well to examine the condition of their banks to see whether the proposed clearing-house currency would be safe if issued by them.

The following figures are taken from the report to the comptroller of the currency for September 20, 1898, and relate to national banks only.

STATEMENT OF CAPITAL, DEPOSITS, LOANS, AND RESERVES OF
BANKS IN THE STATES OF KANSAS, NEBRASKA, AND ALA-
BAMA, AS SAME STOOD ON THE 20TH OF SEPTEMBER, 1898

State.	No. of Banks.	Capital.	Deposits.	Loans.
Kansas . .	102	\$8,417,100	\$22,507,499.71	\$21,745,527.64
Nebraska .	102	10,225,000	23,370,946.52	25,095,894.00
Alabama .	26	3,205,000	6,765,332.06	6,681,950.33
	230	\$21,847,100	\$52,633,778.29	\$53,523,371.97

LAWFUL MONEY RESERVE.			DEPOSIT RESERVE.	
	Amount.	Percent- age of Deposits.	Amount.	Percent- age of Deposits.
Kansas . .	\$2,310,265.57	10.26	\$5,259,015.54	23.36
Nebraska .	3,674,328.07	15.72	8,421,907.68	36.05
Alabama .	1,029,954.21	15.22	765,013.75	11.30
	\$7,014,547.85	13.32	\$14,445,936.97	27.44

Under the proposed system of incorporated clearing houses, the available cash means of the banks in the above three States would be as follows : —

		Percentage of Deposits.
Lawful money reserve	\$7,014,547.85	13.32
Deposit reserve	14,445,936.97	27.44
Clearing-house currency	21,847,100.00	41.50
Available money	\$43,307,584.82	82.26

Under the present system, the lawful money reserve of 13.32 per cent is entirely inadequate to ward off panics, and in a panic the deposit reserve becomes immediately unavailable. No help of any account can be had from clearing-house certificates in those States.

Under the proposed bill the deposit reserves and the clearing-house currency to the par of the banking capital would be a sure and available resource, because the one supports the other and both rest on the responsibility of all banks. Together with the lawful money reserve, they would provide the banks with available cash equal to over 80 per cent. of their deposits, which would place them in an absolutely safe condition.

The question for banks in other States to seek an answer to is whether an issue of clearing-house currency to the par of the capital of any bank, guaranteed by the remaining banks, could be absolutely secured out of the assets of the banks in

those States so that no contingent loss would fall upon them.

STRONG POSITION OF BANKS UNDER A CLEARING-HOUSE SYSTEM

If all the banks in those three States should take out clearing-house currency to the par of their banking capital, a contingency not at all likely to happen, the total amount issued would be \$21,847,100, requiring about \$28,000,000 collateral. This collateral security would be the best the banks could offer, and the currency issued thereon would pay down the deposits 40 per cent. and the banks would still have their lawful money and deposit reserves untouched, which would equal 70 per cent. of their unpaid deposits.

This shows how the legal power to issue a clearing-house currency would place the banks of those States in an impregnable position without any danger of loss to banks in other States.

The mere knowledge that the banks had such large available cash means would produce a state of perfect confidence with entire stability.

COMPARISON WITH CREDIT LYONNAIS

Stability is produced in France by the large available reserve carried by the Bank of France, which the regents are free to use without restriction to support French commerce, and a similar effect would be produced in the United States by a clearing-house system. Monetary panics are unknown in France.

A comparison of the conditions of the banks in Kansas, Nebraska, and Alabama under a clearing-house system, with that of the Credit Lyonnais, one of the largest of French banks, under the protection of a governmental bank, shows that in important particulars they would hold approximately the same proportion of reserve.

From the statement of the Credit Lyonnais, dated November 30, 1898, the following figures are obtained:—

Credit Lyonnais, with 145 branches: Capital, \$40,000,000; deposits, \$248,200,000; loans, \$240,000,000; cash (equivalent to lawful money reserve), \$25,600,000; call loans (equivalent to deposit reserves), \$21,200,000.

Under the French system the Bank of France stands ready to use its reserve of about \$600,000,000 to support the commerce of France.

The available cash means of the Credit Lyonnais is therefore as follows:—

		Percentage of Deposits.
Cash (equivalent to lawful money reserve)	\$25,600,000.00	10.29
Call loans (equivalent to deposit reserves)	21,200,000.00	8.57
Bills receivable, which they advertise are "immediately discountable at the Bank of France" . .	126,800,000.00	51.27
Total available money . .	\$173,600,000.00	70.13

It is seen by this that the percentage of available money of the banks in Kansas, Nebraska, and Alabama would be greater under the proposed clearing-house system than that of the Credit Lyonnais is under the French system of a central national bank with an enormous available reserve.

The percentages of reserves to deposits of the two are compared thus: —

	Clearing House System, Kan., Neb., Ala. Banks.	Single Governmental Bank System, Credit Lyonnais.
Lawful money reserve or cash	13.32 per cent.	10.29 per cent.
Deposit reserves or call loans	27.44 "	8.57 "
Clearing-house currency . .	41.50 "	
Bills receivable discountable at the Bank of France		51.27 "
Percentage of deposits . .	82.26 per cent.	70.13 per cent.

COMPARISON OF ANGLO-SAXON AND LATIN SYSTEMS OF BANKING

This comparison is instructive because it shows the difference between banking under Latin and Anglo-Saxon systems. The distinction is fundamental. The Anglo-Saxon spirit of "individual initiative" demands individual banks and will not permit a single governmental bank monopoly. We are therefore compelled, in order to reach stability, to develop the clearing house to take the place occupied by the central monopoly of the govern-

mental bank, which is odious in our eyes. The central governmental bank performs to a great extent the functions of a clearing house, and in countries where such a bank exists clearing houses are not a necessity and do not flourish. The clearing houses of France, Germany, and Switzerland are unimportant institutions, while in Great Britain and the United States they are essential. Since a central governmental bank with monopolies is repugnant to our institutions, we must develop and legalize our clearing-house system to take its place. That system is natural to us because it is in harmony with our institutions, and is based on the principles of representative government.

PROFESSOR McLEOD'S PRINCIPLE OF A SOURCE OF ISSUE

This comparison corroborates Professor McLeod's principle and shows that, whether under a system of individual banks or of a banking monopoly, "in our modern system of credit it is indispensably necessary that there should be some source to create and issue solid credit to sustain solvent houses in a monetary panic."

A bank as large as the Credit Lyonnais, with its 145 branches and \$40,000,000 capital, needs the support of this source equally with the humblest trader. A system of incorporated clearing houses can be that source better than a single governmental bank, because it would not produce centralization, but would diffuse its benefits over the whole country.

OBJECT OF PLAN IS STABILITY, NOT EXPANSION
OF CURRENCY

Issues under the supervision of a clearing house might be expected to be made in a safe and conservative manner. The object of the plan is not so much to stimulate business as to give it stability. Clearing houses are one remove from the borrower with his urgent requests. The element of contingent liability always acts as a wholesome restraint. Yet the power to support the commercial community would exist and could be promptly used in case of need. The knowledge of that fact would insure stability under the Anglo-Saxon system through the clearing house, as well as under the Latin system through the single monopolistic governmental bank.

“NEVER CLOSE UP, BE ALWAYS READY TO
CLOSE UP”

Count Mollien, minister of the treasury of the first Napoleon, stated the following principle to the regents of the Bank of France, the 29th of May, 1810:—

“It is necessary that a bank shall hold itself in a condition to liquidate at any moment. *In order never to close up, a bank should always be ready to close up.*” The italics are his.

This is the condition in which the banks of the United States should be. They are not in that condition now; their reserves are entirely inade-

quate. It behooves our lawmakers to give us a bill to set at rest forever the ability of our banks to take care of themselves in any panic, however violent. That end could be reached by a law incorporating our clearing houses with power to issue a clearing-house currency.

XI

CONTRAST BETWEEN AMERICAN AND EUROPEAN SYSTEMS OF BANKING

IN the issue of the New York "Commercial Advertiser" of July 21, 1899, there is a closely reasoned and able article bearing the title "Banks and Finance." For the purpose of promoting the discussion on this important subject, and not in a spirit of criticism, it may be opportune to consider the trend of that article and to base thereon a contrast between American and European systems of banking, from the standpoint of the former and not of the latter.

The article in question may be condensed as follows: The writer says that general European experience approves a single governmental bank, in which the functions of issuing notes and lending money are united, which gives the bank the power to check credit speculation automatically; that "public inexperience and distrust have so far prevented the adoption of this system in the United States," but the "natural operation of economic forces" has brought about something resembling it in the voluntary association of our banks; and that the fundamental objection of scientific stu-

dents to our banking system has been that the separation of the two banking functions of issuing notes and lending money has deprived it of the automatic check found in the European systems.

An approval of the European system of a single governmental bank similar to that contained in this statement is often met, and should be fairly considered. At the start it must be said that the real ground for the approval is not that the European government bank is single, or that it is governmental, but that it possesses the function of note issue on banking assets, and is thereby enabled to support not only the popular banks which do not have that privilege, but all commerce and trade. The approval, therefore, is not necessarily of the way in which the problem has been worked out in Europe, but of the rule by which it must be solved in any nation. When once the underlying principle of the credit system is recognized, then the solution of the banking problem may be proceeded with in accordance with the requirements of each individual nation. The generalization then, which is the important matter, is that the credit system requires the organization of popular banks to do the business of a country, and also the organization of one or more institutions which shall have the power of note issue on banking assets, and thus shall be able to come to the support of the popular banks, either to facilitate their ordinary business or to protect them and all commerce and trade in times of

financial alarm. If this principle is recognized, it can be applied to the banking system of any country, whatever its kind of government may be. In countries accustomed to initiative by the government, such as Germany, the Latin nations, Japan and Turkey, a single government bank would be preferred, with specially chartered popular banks. In countries accustomed to private individual initiative, where jealousy of monopoly exists, as in the United States, all banks and other financial institutions must be organized under a general law.

In the United States we have "so far" only a general law organizing popular or multiple banks, with power to issue notes only on government bonds, which method is delusive and valueless to support credit, as every panic has shown. To complete our system in accordance with the laws of credit, we need another general law, authorizing the organization of institutions with power to issue notes on banking assets for the support of banks and commerce. When this is accomplished, our system will be completed and made parallel, though not uniform, with European systems.

The banking systems of Europe have been completed in an easy and direct way, though in disregard of our ideas of popular rights, by the creation of their specially chartered government banks with the power of note issues. Our system, therefore, lacks a corresponding member, note-issuing institutions, to make comparison between

the two equal. This member or counterpart may be supposed to exist and then a perfect comparison can be made. The lack of a member is a reason for supplying it, and not for destroying the system and building anew from the bottom on another model.

The laws of the credit system may be complied with under any form of government, whatever the banking system is which has been adapted to it. A banking system of any country is a growth which conforms to the prevailing political principles of that country. It can be easily traced in any instance, and a knowledge of its formation is necessary to determine the kind of adjunct the credit system requires.

Our banking system began with the Declaration of Independence, which is a protest against class legislation and monopoly, and a proclamation in favor of freedom and equal rights. It advanced a step by the adoption of the Constitution of the United States, by which a solid monetary system was established. It was moulded again by the hand of General Jackson when he vetoed the bank charter in 1832, and thus overthrew an organization hostile to and incompatible with republican institutions, which stood as the representative of specially chartered banks. An epoch-making step was taken when banking in the United States was first made truly republican by the enactment of the New York free banking law of 1838, which was then called a second Declara-

tion of Independence. The principles of that law were made national and fixed in enduring form by the National Bank Act of 1863. From what has heretofore been said, it will be noticed that the only point requiring adjustment in that law would be remedied by some provision or arrangement or the incorporation of special institutions to make issues of bank notes on banking assets. This requires the addition of a new method, but not of a new principle. The principles of the banking system of the United States are that banking shall be done under a general law, with government supervision, and that the function of the issue of bank notes shall be separated from that of lending money.

Thus we have traced the few steps in the development of our present banking system. Thus established it is the logical result of the principles of the Declaration of Independence, and must be recognized and accepted, unless we wish to take the revolutionary position that the fundamental principles of our government are wrong and the legislation which has grown out of them should be reversed. These are fair topics for an academic discussion, but the people of the United States have given no token of a desire to abandon their political faith or to retrace the steps of its historical development.

If the discussion is on the best practical move to be made for the perfecting of our banking system in line with the republican principles which

have hitherto governed its development, then those must be ruled out of order who would bring up for consideration the proposition that the system be abandoned and one adopted in its place which is the outgrowth of a different form of government and a different state of society from ours.

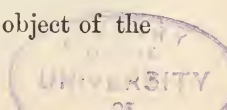
Nor can it be said in the light of history that "public inexperience and distrust" have been the guiding motives that controlled our nation in the development of its banking system. The state papers and legislative debates on the subject of banking and currency recall the names of Hamilton, Madison, Gallatin, Webster, Marcy, Benton, Dix, Chase, McCulloch, Tilden, and many others whose writings and speeches deserve more study than they receive from the present generation. Can it not be said with a glow of national pride that our system of free banking, under general laws, with government inspection and public statements, springing from the germ of independence and cultured in the soil of freedom, is a model for the world, and is the crowning glory of Republican legislation?

But coming down to the present time, the writer of the article we are considering thinks he has found an objection to the American system of banking in the separation of the functions of note issues and lending money. As far as banks in the United States have the function of note issue, it is separate. It is a question, however, whether

separation does not exist in France and Germany as well as in the United States. In those two nations both functions are possessed by a single government bank, or a small number of banks, but the thousands of popular banks, which do the greatest part of the banking business of those countries, do not have the function of note issue. Complete separation exists as regards popular banks, and any proposal to unite the two functions in popular banks would receive as little support in either of the legislative assemblies of those nations as it would in the Congress of the United States.

The objection to the union of the two functions in popular banks is that thereby all check to credit speculation would be removed. The history of banking proves this. If collateral security on which note issues are to be made must pass the inspection of a separate body of directors or of a loan committee, then the separation of the functions becomes an automatic check to over-issues and credit speculation.

Too much may be said of the importance of checking speculation. In rooting up the tares, much of the good crop may be lost. It is better rather to emphasize the thought that it is the duty of banks to facilitate all legitimate business. The first Napoleon said to his finance minister, Count Mollien: "You must say to the governor and regents of the Bank of France that they should inscribe in letters of gold in the place of their assembly these words: 'What is the object of the



Bank of France?’ It is to discount the credit obligations of all the commercial firms of France at 4 per cent.” That the rate of interest on call loans reached 16 per cent. in New York, as it did early in July, 1899, is evidence of a defective banking system. There was nothing unhealthy in that temporary demand for money, and our system should have furnished the cash without causing a shock to credit which all business felt.

Since separation of note issues is not a peculiarity of the banking system of the United States, and does furnish the best check to speculation, then it must result that the objection to our system which “scientific students” have is not in the separation of note issues, but in the way that function is performed, and this is a point which the article does not refer to.

In France and Germany note issues are based on commercial obligations or banking assets, and they give relief to commerce and trade. In the United States bank note issues are based on government bonds, and therefore they afford little relief or assistance to the commercial community. When a bank takes out currency on bonds it diminishes its power to aid its customers.

The great question which the United States has to solve is how to secure the benefit of note issues on banking assets and yet preserve the benefits which come from separation of the function of note issues from popular banks. “Public opinion,” says our writer truly, “will not permit a

government bank " in the United States. Nor will public opinion favor the giving the power of note issue on banking assets in their own hands and under their own control to four thousand popular banks all over the country. Coining money, for that is what issuing bank notes amounts to, is a sovereign power, the exercise of which should not be delegated by Congress except with the amplest guarantees and the most perfect restrictions.

Our writer has foreshadowed the solution of the difficulty in saying that "economic forces compel a union of private [popular] banks for common performance of" this function. In no other place is the union of popular banks more complete than in the clearing house. Because the American method of note issues does not give aid, support, or relief to the business community, therefore it is that sentiment is increasing in favor of a system of federal clearing houses, with power to perform the function of note issue as it is performed by the banks of issue in France and Germany. Separation with all its benefits would still be maintained, but bank notes would be issued in a way to be of service to the business world.

The system of federal clearing houses would be formed, as the system of national banks is, by a general law of Congress. The form of the law would be similar to the National Bank Act. Under it all clearing houses would be incorporated, and provision would be made for one clearing house of issue in each State, with power to issue

currency to bank members on pledge of banking assets. The holders of such currency would be guaranteed against loss in the same way that holders of clearing-house certificates now are under the rules of the New York Clearing House. The system provides also that all bank members of clearing houses shall accept the notes of all clearing houses in payment of all dues to them, thus maintaining the notes at par from one end of the country to the other.

This system derives its features from the banking legislation of our States and the Congress. It takes the broad foundation of popular, multiple banks organized under a general law in accordance with the genius of our institutions, and builds upon it a superstructure of clearing houses, thus completing our financial edifice and making it a harmonious whole. It first legalizes the association of banks in clearing houses and then enlarges their powers to enable them to meet all the requirements of the commerce of our country. This system is the outgrowth of our own institutions, and it solves the banking question in our own way. It would make banking freer even than it is now. The chief merit of such a system is that it provides sure protection against monetary panics, by establishing sources for the issue of solid credit in times of financial alarm.

At present the association of our banks in clearing houses is voluntary, as our writer says; but to be efficient and responsible and amenable to

government control, clearing houses should be incorporated under a federal law. To federal clearing houses can be safely given all the power needed to cope with any panic. The power to control a panic must be greater than the disturbing force of the panic.

In a federal clearing house is found the American counterpart of a governmental bank, but it is as different therefrom as a president is from a king. A clearing house is democratic, while a governmental bank is aristocratic. A federal clearing house is the result of "the natural operation of economic forces" under republican guidance.

So at last we agree with the writer of the article under consideration, and find in the voluntary union forced on our banks by stress of circumstances the suggestion of a legal union on the same theory, and following the same practice which the experience of fifty years has found to be above criticism, and the suggestion of a system which would be more beneficent in its results than are any of the banking systems of Europe.

XII

BANK NOTE ISSUE A PUBLIC DUTY, NOT A BUSINESS FOR PROFIT

IN his speech before the Senate on the 18th of March, 1834, Daniel Webster said: "Banks are made for the borrowers. They are made for the good of the many and not for the good of the few." Exactly the opposite of this opinion of our great statesman seems to be held by many who act as if banks were created by the government and received their privileges and powers solely for the purpose of making money for their stockholders. The true doctrine which should govern all legislation in reference to banks is that stated by Webster, — that they are formed to promote the business interests of the country and not exclusively or primarily for their own profit.

All proposed changes in our banking system should be judged by this criterion.

The proposition to give the right of note issue to thousands of banks, big and little, all over the country, is fraught with danger to the entire nation, and that consideration alone should shut off any further discussion of the subject. Note issues by a few large banks, with many branches, squeez-

ing the life out of all local banks and creating a money aristocracy, would be foreign to our institutions and incompatible with the public good.

These are forms of "bank usurpation" which can never be tolerated in a free country, and they justly encounter the opposition of all who have the welfare of our country at heart. But the question still remains to be discussed whether or no bank note issues in some form may not be a benefit to the community. Are there not modes of bank note issues whose first object is the protection of business from panic and disaster or its facilitation in times of special activity, and whose secondary object is the profit to the banks? Such modes would not be "usurpation," but the assumption by or the imposition on the banks of a public duty.

Let us consider that aspect of the question. By the credit system which has now been in operation for over two hundred years, banks and all persons engaged in trade and commerce transact their business, not by barter, but by maintaining on hand in cash only a sufficient percentage of their debts to keep the whole alive, or liquid.

The amount of credits and debits created by the credit system is five or six times the amount of the cash reserve. This method of doing business is authorized by appropriate legislation in the form of banking and other laws.

Occasional junctures will happen, caused by unusual catastrophes, when much more currency is

wanted by the community than the law requires banks to keep on hand as a reserve. That is, it may occasionally happen that a bank which has conformed to the requirements of the law is left unprotected and has the disagreeable alternative presented to it of going into the hands of a receiver or forcing liquidations on its customers, thereby creating a panic, with its untold sufferings. To meet this domestic demand some experienced writers and bankers advocate giving to one federal clearing house in each State the power possessed by the government banks of Europe, of issuing to their bank members currency secured by pledge of banking assets with ample margin, such currency to be received at par by all banks for all dues to them. This is proposed, not for the profit there is in it to the banks, but for the security and benefit which would flow therefrom to the people. Some banks might object to this plan, and the answer to them is that it is not just to the business community to expose them to the danger of forced liquidation because no other way of supporting the banks is provided by law except their destruction.

The writers of the article on "Bank Usurpation" in the issue of the 16th, and of the money article of the 14th of August, 1899, of the New York "Sun," offer as a solution of the currency question that required elasticity may be had in crises such as above described by allowing people to deposit gold with the United States Treasury

and get an equal amount of currency to supply their wants. The difficulty with the operation of this plan is that in such circumstances the gold and other legal tender money has vanished because it is all owed five times over and the creditors have called for it. That is the cause of the trouble. This "true scientific" scheme cannot therefore be put in operation at its first step, because it requires the deposit of gold, and there is no gold to deposit.

Must we go on forever with alternations of confidence and panic, prosperity and disaster, and meekly acknowledge that no solution of the banking question can be found? Should we not rather endeavor to find a method of bank note issue which will be safe, scientific, and for the common weal? While European nations have solved the banking question in accordance with their system of government, can we not solve it in accordance with republican principles? Or do our national theories fail when applied to the banking question?

The evidence is not clear that the banks are endeavoring to usurp a valuable prerogative at the expense of the business community. The public looks to Congress for protection against all "bank usurpation." There resides the only power which can impose on the banks the duty of making note issues not primarily for their own profit, but for the benefit of the nation.

The banks of our country in all its crises, from the Revolution down to the war with Spain, have

always shown a sincere and true patriotism. It only remains for Congress to devise a plan to protect the country from monetary disorders, and the cordial coöperation of the banks may be relied on, in the future as in the past, to help carry it out, whatever may be the duties and responsibilities which the plan may impose upon them.

COMMENTS BY THE EDITOR OF THE NEW YORK
"SUN"

Mr. Gilman confounds legal tender money with currency, and a scarcity of currency caused by a demand for it in effecting exchanges with a contraction of bank credits which leads to a panic. A panic is never caused by a scarcity of currency, and it cannot be cured by increasing the volume of currency. It is caused by an impairment of men's confidence in one another's solvency, and comes to an end as soon as that confidence is restored. It is not true that in times of panic "there is no gold to deposit." If it is lacking in one country it can be found in another, and can be brought where it is wanted, as it was brought from Europe to this country in 1893. So long as men will indulge in speculations beyond their means, we must "go on forever, with alternations of confidence and panic, prosperity and disaster," and no tinkering with bank currency will prevent it. The best that can be done is to mitigate the severity of the catastrophes, and that is accomplished, as we have seen many times, by the action

of the banks among themselves, under existing conditions, without the issue of currency. Congress can no more "protect the country from monetary disorders" than it can protect it from floods, droughts, tornadoes, or forest fires.

XIII

“BANK USURPATION ”

*Reply to the Comments of the New York “Sun” on
Bank Note Issue a Public Duty, not a Business for
Profit*

THE comments on the letter published in the “Sun ” of the 25th of August, 1899, state a view of the currency question held by many, and an endeavor seems to be called for to clear up some of the points connected with this important subject on which there may be more accord than appears on the surface.

Michel Chevalier, a high French authority on finance, has congratulated English-speaking people on the possession of the word “currency,” for which no exactly corresponding term is found in the French language. The definition of the word lies at the threshold of the discussion. How much more it includes than legal tender money and bank notes authorized by law to circulate as money, or whether any more, is a subject of dispute, but it is generally accepted that it must be extended so far. Without touching on any controverted point, the word “currency” may be used to designate both legal tender money and bank notes. All currency

is used for transacting the business of the country, but only legal tender money can form bank reserves or be offered by private parties in payment of debts, and it has therefore been called "basic" or "primary" money.

The bank reserves of our country are about sixteen per cent. of bank obligations, not including those of trust companies or savings banks. This percentage on its face is too small, and our experience has shown that it falls to what Bagehot calls the "apprehension minimum" on slight provocation. When such a fall takes place the banks must set about restoring their reserves from the reservoir of the public. The public then takes fright at the condition of the banks and at their restrictive measures, and proceeds to fortify its private reserves by hoarding currency of all sorts drawn from the banks and the public. Under our banking system there is no way of protecting reserves except at the expense of the public.

It is evident that reserves of legal tender money could be protected if the banks could meet temporary demands in any form of currency acceptable to the public. To be acceptable it must be solid and independent of the banks. A bank cannot pay its debts in its own notes, nor can a man meet his obligations in that way. The notes must therefore be issued by one or more corporations independent of popular banks, and those corporations must be secured by pledge of satisfactory collateral. The notes must be acceptable to all banks,

so that their use in business transactions shall be unrestricted. Such notes would not be legal tender; but being authorized by law to circulate as money, and being solid in character and of universal acceptance, and being obtainable by pledge of banking assets to the limit of the capital of each bank, the great creditor of the banks, the public, would accept them as money.

By the aid of such notes, the banks could meet temporary demands without paying out their legal tender money, which would thus be held to meet foreign demands. This would protect the legal tender reserves, and their decline to an "apprehension minimum" from any domestic demands would be avoided. An issue of bank note currency of this character would afford a complete protection against monetary panics of a domestic nature, because they arise only from the low condition of banking reserves and never from lack of confidence between men in each other's solvency, which is the effect of a panic, not its cause.

Panics have always been calmed by an issue of undoubted currency. Montague, Lord Halifax, so quieted the monetary disorders of 1696 when the Bank of England suspended payment, two years after it commenced business, because its reserve had fallen to less than three per cent. of its demand obligations. Senator Benton, in debate on Webster's "Plan for an Exchequer," said Walpole made similar issues. Sir Francis Baring in 1797 tells us how the panic of 1793 was dissipated by

the issue to merchants and others, by a parliamentary commission, of exchequer bills on pledge of collateral — a method in all points similar to that pursued by a loan committee of a modern clearing house. The Bullion Report of 1810 says that an expansion of the currency is the true remedy for a panic, a dictum to which subsequent authorities have generally given their adhesion. Webster's "Plan for an Exchequer" was based on this principle. In numerous panics in this country from 1857* down, we have seen issues of clearing-house certificates which have alleviated panics, though entirely inadequate to prevent them, by allowing an expansion of the currency beyond that permitted by law. McLeod shows that all modern English panics have been abated in the same way.

The chain of historical evidence is complete from the founding of the credit system to the present day, all confirming beyond possibility of dispute the dictum of the Bullion Report of 1810, that the true mode of quieting a panic is by increased issues of currency. Professor Sumner's comment is that the currency described must be of a kind that will not fail in the wildest panic.

Perhaps the subject may be made more clear by marking the distinction between commercial and monetary crises. A commercial panic in wheat or real estate or stocks comes from over-trading. A monetary panic comes from a depletion of bank reserves, from whatever cause. Errors of judgment in speculation may be expected while the

world stands. The banking system should be able successfully to resist such strains. The collapse of the copper syndicate in France produced a commercial crisis, but not a monetary one, because the French banking system is strong enough to withstand such pressures.

A further distinction should be made between a catastrophe caused by a monetary panic springing from the defective laws of man, and a catastrophe caused by the violent action of the laws of nature. Man did not make the laws of nature, and has no control over them. We must distinguish between an act of Congress and an act of God. German and French banking laws show us that panics can be avoided, as they have been in those countries since appropriate banking laws have been enacted. Professor Dunbar makes this clear as to the German law. But no laws of man have ever curbed the violence of a tornado. Banking is a creation of man, and he can control it and prevent it from being disordered by making the system conform to the simple laws of credit.

In the comments referred to above, all is conceded that is needed to avoid panics. The words are: "The best that can be done is to mitigate the severity of the catastrophes, and that is accomplished, as we have seen many times, by the action of the banks among themselves, under existing conditions, without the issue of currency." This is a ray of light to show the way out of the cavernous darkness in which our banking system

now gropes. The banks have mitigated many panics by issuing a currency between banks called clearing-house certificates. This has been done with entire safety, and the principle on which the issues have been made has been tested by experience and proved to be sound and good. A certificate is remedial, not preventive ; local, not universal ; extra-legal, not legal ; limited, not adequate to the work to be done.

It is a simple matter to cure the defects of the clearing-house certificate, and make it an agent possessing sufficient power to prevent monetary panics in the future. Three objects are to be attained. Let it first be legalized by the incorporation of clearing houses under a federal law with power to do legally what has hitherto been done extra-legally ; and secondly, let the currency be authorized to circulate among the people instead of between banks, so that the banks may thereby protect their reserves of legal tender money ; and third, let the benefit of this mitigation be enjoyed by all the nation by giving to one clearing house in each State the power to issue such currency.

It is the opinion of some of the most prominent experts in finance of our country that domestic monetary disorders could not occur if this plan were adopted by Congress.

XIV

THE GOLD STANDARD

BY the adoption of the Constitution of the United States in 1788, the country was placed on a gold basis. Its provisions on the subject are twofold. In Section 8 of Article I. it reads, "The Congress shall have power . . . to coin money, regulate the value thereof, and of foreign coin." In Section 10 of Article I. it reads, "No State shall . . . emit bills of credit; make anything but gold and silver coin a tender in payment of debts."

Webster in commenting on these provisions said, "The powers granted to Congress are enumerated one after another in the eighth section, and the prohibitions to the States in the tenth section. The grant to Congress is 'To coin money, regulate the value thereof and of foreign coins.' The correlative prohibition on the States, though found in another section, is undoubtedly to be taken in immediate connection with the foregoing as much as if it had been found in the same clause. The only just reading of these provisions, therefore, is this: 'Congress shall have power to coin money, regulate the value thereof, and of foreign coin; but no State shall coin money, emit bills of

credit, or make anything but gold and silver coin a tender in payment of debts.' These provisions respect the medium of payment or standard of value, and thus collated their joint result is clear and decided." And in his speech on the Sub-Treasury, delivered January 31, 1838, he said, "Sir, it will be a fact stamped in deep dark lines upon our annals, it will be a truth which in all time can never be denied or evaded, that if this Constitution shall not, now and hereafter, be so administered as to maintain a uniform system in all matters of trade; if it shall not protect and regulate the Commerce of the country, in all its great interests, in its foreign intercourse, in its domestic intercourse, in its navigation, in its currency, in everything which belongs to the whole idea of commerce, either as an end, an agent or an instrument, then that Constitution will have failed, utterly failed to accomplish the precise, distinct, original object in which it had its being."

The distinction was a broad one in the minds of the people in 1788. It was a choice of the metallic currency of the world and a setting aside of an irredeemable currency. There have been many political contests to overthrow this fundamental financial law of our country, but the effort has always been in vain. Even when commerce and trade were almost prostrated by successive panics, the majority of the people were found true to the national principle that every dollar authorized by the government to circulate as money, must be as

good in its purchasing power as any and every other dollar.

In view of the fact that the gold standard is imbedded in the Constitution and has been reaffirmed by the popular vote again and again in national and state campaigns, the demand of some that an additional declaration should be made by Congress seems superfluous. The people have taken their position, and there is no fear that they will ever recede from it. But if they choose to change this financial principle, there is no power to compel them to adhere to it. While this may be accepted as true, there may yet remain something to be done in granting power to the proper official of the government to carry into effect the will of the people, and some legislation may be required to make it a duty of the secretary to see to it that the uniformity of the currency shall be upheld. It is one thing that a law shall be permissive and another that it shall be mandatory. If a law should be passed by Congress making it "the duty of the Secretary of the Treasury to maintain the gold reserve at such sum as shall secure the certain and immediate redemption of all notes and exchange of all silver dollars presented at the Treasury of the United States," and authorizing him, "for this purpose to issue and sell, for gold, whenever it is in his judgment necessary to the ends aforesaid, and for no other purpose, certificates of indebtedness of the United States bearing interest at a rate not exceeding three per

centum per annum, payable in gold coin at the end of five years but redeemable in gold coin at the option of the United States after one year," then the question of maintaining the gold standard would be settled as far as legislation can settle it. This is all contained in the 4th Section of bill H. R. 10,289, 55th Congress, commonly known as the Committee's banking bill. It was the intention of that section to make it mandatory on the Secretary of the Treasury to maintain the gold standard and to give him power to carry the mandate into effect. What more is needed than to compel the Secretary of the Treasury, when the government's stock of gold is running low, to replenish it, and to designate the kind of bond he could sell to accomplish that object?

Even a secretary not in sympathy with gold would hardly refrain from obeying a direct law. The simple proposition of the Committee on Banking and Currency of the House of Representatives of the 55th Congress would seem to meet all the requirements of the case and dispose of the question of the standards forever. Then it would become unnecessary to set aside in idleness a large sum as a reserve fund. A reserve power would be as effective as a cash reserve.

XV

CENTRALIZATION ; BRANCH BANKING

FEW governments in the world have a greater centralization of power than is placed in the hands of the President of the United States. Few governments, if any, disperse the privileges and the benefits of the nation so widely among the people as does the government of the United States. It is a political principle with us that there shall be no privileged classes, or unequal bestowal of advantages in any part of the country.

This feeling is not based on jealousy, but upon justice and an intelligent opinion that it is best for the country, as it is for an individual, to be developed equally in every part. The wasting away of a member of the body poorly nourished and neglected finds its counterpart in the lack of development of a section of the country which is deprived of the advantages that the most favored enjoy. Especially is this true in reference to the currency.

It is the duty of the government, as said by Sir John Sinclair, in 1822, to promote an abundant circulation, especially in the country districts. "It is by means of a country circulation that im-

provements in agriculture can be carried on with spirit, that the produce of the soil, the real basis of national wealth and true source of productive industry, can be increased, that the farmer, the first link in the chain of national circulation, can be provided with a circulating medium which through him will soon pervade and enrich all the other classes of the community." "In this way every part of the nation may possess the advantage of an abundant circulation, and that command of money, from which the prosperity of commerce and of manufactures so much originated, may be also enjoyed by agriculture, even in the remotest districts."

"Water the roots" is an injunction which should govern the mode of distribution of the currency. This cannot be accomplished if the money of the country is congested in one place or if it is issued from a single source. It must be locally issued, at the localities where it is to be employed in trade, and where the credit of borrowers is best known. A clearing house of issue in each State would reach the entire country. By this diffusion of circulation the notes of farmers and local traders could be made the basis of the issue of currency when approved by the local bankers and the loan committee of the clearing house. No part of the country would be passed by in the bestowal of the benefits of circulation. When the currency so issued has performed its service, it is redeemed and canceled, and does not seek a

money centre to foster speculation until it is wanted again.

The opinion is urged by some that the issue of currency through branch banks will accomplish the result of local issue. Branch banking is a form of centralization which can never be made to harmonize with our institutions. The example of foreign nations is often referred to with the assertion that the practice of branch banking is almost universal among them. There is no country where banking is more centralized than in France, and it is apropos to notice that sentiment is not unanimous in its favor there. The existence of the French Country Bankers' Association, of which G. Vignes, Troyes, France, is secretary, shows that there is in that country a decided opposition to the system. The object of the association, as stated in Article II. of its Constitution, is, "To form a centre for discussion and for obtaining information as to the means of resisting the encroachment in the provinces of banking establishments from Paris." The association has offered a prize of one thousand dollars for the best essay on "the advantages of local banks." The offer says, "The length of time their directing bodies remain unchanged, the services they render in crises, the community of interests existing between them and their customers, the decentralization of the affairs, and division of risks, the stimulus they give to local industries, — these are not among their least advantages."

It will be difficult if not impossible, for a long time, for the country bankers of France to throw off the yoke of the branch banking system, and yet their arguments will no doubt be accepted in this country as conclusive to prevent the establishment of the system here.

Financial centres should have all the money they need to carry on their business, and in the same way, though less in amount, each part of the country should enjoy equal advantages. There should be ability to centralize the financial power of the nation and use it when occasion demands for the benefit of all, and there should also be a diffusion of financial benefits by means of a locally issued circulation. By this means the whole country would be equally developed, each State would have the control of its own finances, the pressure would be relieved which is now periodically felt in large money centres, and centralization would no longer be the complaint of one section against another.

XVI

THE CLEARING HOUSE

*How it may be utilized in the Issue of a Bank Credit
Currency*

IN the "Bankers' Magazine" of New York for February, 1899, John H. Blacklock, of Baltimore, Md., gave the banking public a most valuable and comprehensive, as well as able, article on "The Clearing-House, Its Constitution, Rules, and Practical Working Forms." The article is timely, for it treats of a subject hardly second in importance to any other which commands the attention of the business community.

CLEARING HOUSES REPRESENTATIVE IN CHARACTER

The first and fundamental characteristic of a clearing house as described by Mr. Blacklock is that it is based on the principle of equality and representative government. Every bank joining a clearing house is the equal in rights and privileges of any other bank. The rules of the association apply equally to all. Section 4 of Article IV. of Mr. Blacklock's constitution reads: "At all meetings a majority of the members of the

association shall be a quorum for the transaction of business. All motions and questions shall be decided by a majority of the members present except where it is otherwise ordered in this constitution." The exception seems to be in the issue of clearing-house certificates, when "a vote of three fourths of all the members of the association " is required to authorize their issue.

These provisions make of the clearing house a miniature republic, and as such it is in harmony with a government of, by, and for the people.

MEMBERSHIP SHOULD BE A RIGHT AND PRIVILEGE

The next consideration, to make the clearing house acceptable to the citizens of a republic, is that membership therein shall be the right and privilege of every bank, duly organized under state or national law. That is, the possession by a national bank of a certificate from the comptroller of the currency that "such association has complied with all the provisions required to be complied with before commencing the business of banking, and that such association is authorized to commence such business," should entitle said bank to membership by simply filing this certificate with the clearing-house association.

A state bank duly authorized by a state superintendent of banking to do business as a state bank should also have the same right and privilege of membership on presentation of a regular certificate.

To require further examination, or to impose any other tests or conditions, would be an expression of doubt as to the thoroughness of the inspection by the comptroller or superintendent or of the value of their recommendations.

By these provisions the right to membership in the clearing house would be as free as the right of an adult citizen, duly enrolled, to vote.

If this were not the case, it is evident that local competition or jealousy might control the banking of a city or other locality. The organization of the clearing house should be free from all taint of monopoly, and the republican spirit which demands general laws and free banking should control in the formation of clearing houses as in that of popular banks.

SUSPENSION OF MEMBERS BY REGULAR PROCESS

No national or state bank should, on the other hand, be deprived of its clearing-house membership except when it is in default or when the comptroller or superintendent has appointed a receiver therefor. That is, all summary and irregular action, which may be prompted by other considerations than those of solvency, should be carefully guarded against. The provisions contained in Section 4 of Article II. and Section 4 of Article V. of Mr. Blacklock's constitution, which prescribe the mode of suspension, are excellent in scope and effect, and perhaps do not require any change. These two sections provide against all arbitrary

action which might unjustly deprive a bank member of its rights. Such protection is needed to secure the confidence of all stockholders and depositors.

The three points above referred to are, first, that the clearing house should be democratic, and second, that it should be free to all, and third, that the rights of all its members should be carefully preserved and no member should be deprived of any except by due process of law.

CLEARING HOUSES SHOULD BE INCORPORATED BY THE GOVERNMENT

It immediately becomes evident that if a system of clearing houses is to be established having these characteristics, it can be accomplished only by a general federal law providing for the incorporation of clearing houses. Such a law would simply authorize the formation of clearing houses, in the same way that the National Bank Act provides for the formation of national banks, or a state law provides for the formation of state banks. The National Bank Act allows some latitude in the articles of association, requiring only that they "shall specify in general terms the object for which the association is formed, and may contain any other provisions, not inconsistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs." The whole act, however, in a sense becomes the by-laws of every national bank. So an

act incorporating clearing houses need only outline the salient features of such an association and leave each to make rules for its government. Some clearing houses would need but few rules; others, with more complex and greater interests and questions to guard, would require more elaborate rules.

CHIEF REQUIREMENT, A GENERAL LAW

But the chief thought underlying the whole subject is that in a democratic country with a representative government, in which all questions are decided by a majority vote, banks and all other organizations can form a union only on the political principles which constitute the basis of our government.

PROVISION FOR A CLEARING-HOUSE CURRENCY

If the law under which clearing houses are organized is a federal law, and prevails over the whole country, it would then be possible to provide for a clearing-house currency instead of clearing-house certificates. The federal power alone can do this. A currency issued in the same manner as provided for the issue of certificates would be as safe as certificates are. If issued as currency in all denominations from one dollar up, the banks could pay them out to their customers and thus keep their legal reserves without diminution. Clearing-house certificates weaken the banks issuing them, as well as the banks that receive them,

by displacing legal reserves. A clearing-house currency so issued, limited in amount to the par of the capital of any bank, would provide the banks with a resource which would strengthen and protect them against any panic.

THE CLEARING HOUSE TAKES THE PLACE OF A GOVERNMENT BANK

In monarchical countries the single governmental bank supports all the popular banks with its power of issue and great reserve. In a country where a representative government prevails, the clearing house may be developed to afford more perfect protection than a governmental bank, not only to all banks, but to the whole business community.

The thoughts of financial men are now turning towards the development of the clearing house as the means by which this country may reach monetary stability and freedom from panics, and Mr. Blacklock's article is a great help in the direction of showing how simple the formation of a clearing house is, and how great the advantages would be to the whole country from the wide extension of the system.

XVII

LIQUIDATION, COMMERCIAL AND BANK

USED in the sense in which it is current in business circles, the word "liquidation" means the turning of a debt or an ownership in any property into cash. Thus liquidated wealth is spoken of to describe property of a character so convertible as to be readily converted into cash. Assets are called liquid when they possess the property of convertibility. Liquidation is the end of a business transaction, because by it property which could be used only to purchase other property by barter, is by liquidation transformed into money, which is a means by which any property offered for sale may be bought, or a legal tender by which any debt may be satisfied. By liquidation an account is closed, and the profit or loss, which can only be estimated after liquidation has taken place, is realized.

What may be called commercial liquidation occurs when the principal or owner has carried through his transaction to its natural ending, and, finding a satisfactory purchaser, is ready to close in the ordinary course of his business. When a farmer has harvested his crop, when a manufac-

turer has turned out his finished product, or when the importer has transported his goods to market, they all are ready to liquidate their commodities, turn them into cash, balance profit and loss account, and get ready for another operation. This is the regular course of business, and on its successful movement depends the ability of the workers of a country to provide food and clothing for those who are dependent upon them. This routine is as regular as the rising of the sun, which calls man to his labor; it is as unfailing as the appetites to be satisfied, and as continuous as the flow of time.

By means of the credit system the operations of business are multiplied, and therefore the profits and the well being and comfort of a people. The argument in favor of the establishment of the credit system was well stated in a dialogue between a country gentleman and a London merchant, published in 1683, nine years before the Bank of England was chartered; and it is just as convincing now as then. The country gentleman asked, "How does the bank help business?" to which the merchant replies, "The bank will lend manufacturers money on their stock, so they can keep on manufacturing." The country gentleman then asks, "How can the bank enlarge their credit?" The merchant answers, "They may deposit goods they cannot sell and raise new credit on them of at least three or four times the value of the goods they deposit." It will be noticed there was nothing slow about this seventeenth-century

merchant. He continues, "The bank will increase exportations and importations. The importer can remit two thirds or three quarters of the value of the goods to his correspondent without staying for a market, which tends to make England the emporium of Europe."

The definite object of the credit system, inaugurated nine years after this dialogue was printed, was to increase business over what it would be if conducted only by barter or by an actual payment of cash in full for each purchase. The anticipations of the results coming from the establishment of the Bank of England were fully realized in the increase of business and national prosperity.

But the intervention of a bank and the use of credit introduced a danger as well as an aid to the business it created. The theory of the system is that the borrower will not be disturbed in his business, and the help given him by the bank will be as constant and firm as if he was trading by the system of barter which was supplanted by the new system of credit. The merchant has a right to expect that the new system shall be just as good as the old. The credit provided by the Bank of England was so strong, and the capital of the bank was so great, that for a century at least the merchants had no reason to complain of the treatment they received. Credit seemed just as good as barter, and the resulting profits were far greater, and the wisdom of the change from the old system to the new was not questioned.

There is a danger, however, lurking in the credit system, because it is based on the law of averages, and that law is liable to exceptional as well as ordinary averages. The bank may encounter unusual vicissitudes, and not be able to carry out its engagements, and then the reliance on which the merchant has been conducting his business may prove to be not well founded. The merchant relied on the bank to help him to carry on his business until he reached its natural conclusion, the time when a profitable liquidation could be accomplished. His part of the bargain was to pay the bank for the use of its credit, and the part of the bank was to keep that credit as good as gold and as stable as barter. The merchant represents the people, and the bank is the other party.

It is manifestly a one-sided transaction if the bank, after having induced the merchant to pay it for its credit, abrogates its part of the engagement but holds the merchant to his. But this state of affairs has frequently occurred since the establishment of the credit system. When it does occur the merchant has to face another kind of liquidation than that which comes in the ordinary course of business.

It is a forced liquidation, forced upon the merchant by the bank with no regard to his business, or whether the liquidation results in a profit or a loss to him. The bank then virtually says to the merchant, "Circumstances have arisen, over which

I have no control, which prevent me from carrying out my part of the bargain any longer. I proposed to give you a substitute for barter that was equally good and stable, but my provision to enable me to do so was calculated only for ordinary times, and extraordinary events have occurred which have exhausted my ability, and I am sorry that I cannot continue to make money out of you, but I am unable to do so, and I must ask you to liquidate your business to a sufficient extent to enable you to repay your bank debts." The merchant might endeavor to recall the arguments used when the credit system was established, but he is met with the answer, "Ours is only a tacit moral obligation, while yours is a legal and enforceable one, and there is no other way out of the trouble except a forced liquidation."

This is no fancy sketch, but a description of events which have occurred many times since the credit system began to be. It shows the difference between commercial and bank liquidation, and the cause of the latter. When a bank liquidation takes place, there are some who are ready to ascribe the trouble to the borrowers. We read such expressions as these: "There is enough money to meet the legitimate requirements of the situation." "Small traders on light margins and big traders who are carrying more stocks than they can handle are the only people who are suffering from the present high rates of money." "Many more loans will be called before the banks complete their current

movement of loan contraction." "The situation demands drastic loan contraction." "The weak holder is selling and the strong holder is buying."

What sin, it may be asked, has the trader committed in making his transactions with the banks, that he should be visited with punishment as if he were a malefactor? What justice is there in a situation which sacrifices the weak holder and plays into the hands of the strong?

Whatever the ethics of the case may be, it remains true that the credit system as practiced in our country and England exposes the trader to another kind of liquidation than that which is natural and healthy. It is one which he cannot foresee or guard against, and it comes from our "evil and misguided system," as one writer has called it, which occasionally breaks down, at which times the banks cannot fulfill their undertaking to furnish the commercial world with a safe and stable system. The deduction is that the banks need help to enable them to fulfill their part of the contract with the public. Completing the contract, so to call it, at the expense of the other party thereto cannot be accepted as just or satisfactory. The credit system should be maintained without loss to the public. This can be done only by providing an adjunct to give the banks whatever assistance they need to carry out their undertaking, without damage to the other side. This adjunct, it is claimed, must be a higher order of institutions than the banks, and the effort in this

book is to prove that our clearing houses can be made that adjunct, so that forced liquidations from failure of the credit system may cease entirely.

Neither panics nor forced liquidations can take place under a system of barter, because exchanges thereunder are made only for commodities of equal value. Such a system has no need of banking or credit laws. The system which takes its place should have all of its merits and none of its limitations. Otherwise the credit system may be stigmatized as a cheap and flimsy construction built on the shifting sands of speculation, against which, if the winds blow, it falls. The credit system should be built upon a foundation as solid as gold. In countries with a monarchical form of government, the foundation is a central government bank. In a republic the required assistance and strength can be had more safely and beneficently through our clearing houses. In either case the business public is guaranteed that business transactions may be carried through to their legitimate conclusion without the danger of a bank liquidation.

XVIII

THE INELASTICITY OF OUR CURRENCY

THE trouble caused by the pressure for money now (September, 1899) experienced throughout our country is one that can hardly be satisfactorily accounted for and disposed of except by laying it at the door of our banking system. A monetary disorder can be traced back to its origin as plainly as can a typhoid infection. Money was easy enough a few weeks ago ; now merchants find that the market for commercial paper is almost brought to a standstill. There is a general disturbance of business, of which the commotion at the Stock Exchange is only a symptom.

What is the explanation of this remarkable change ?

In the first place, it is evident that the great prosperity so apparent to us all has required as its natural result the circulation of an increased amount of money among the people for many uses. One of these many uses is to pay wages to the operatives who have at last found plenty of work at home, some of whom have made the bridges and other manufactured products we are sending across the ocean. That our country has begun to com-

pete in the markets of the world is a true subject for congratulation. This free circulation of an enlarged amount of money is a healthy sign, but it is necessarily accompanied by a corresponding decrease of reserves of currency.

In the next place, it is evident that, notwithstanding this increase of circulation and decrease of reserves, an additional amount of money must be provided for the usual fall business, which includes the movement of the crops. The process of sending money out into the country to pay farmers for their crops is the initial business movement of the year, and it should be facilitated in every way, so that the farmer shall get the most possible for his crops and so that other industries and trades shall not be disturbed by the operation.

It is therefore a source of national regret that when this further demand is made on our banking system for currency for the fall business and to move the cotton and other crops, which is a healthy, natural, and temporary demand, we discover an utter inability on the part of our banks to perform this service without withdrawing their facilities from trade centres and producing a semi-panic. This is because our currency is fixed in amount, and therefore rigid and without elasticity, and when an extra demand is made there is no way of supplying it except by causing forced liquidations and denying accommodations unless at high rates of interest, and otherwise restricting business.

That such a monetary disturbance could occur

in plain view of so much prosperity is a national humiliation. Our banking system ought to be able to meet such demands as we have had in the past few weeks without the slightest tremor.

The inelasticity of our currency is the chief defect in our banking system, and it brings unmeasured damage and inflicts a great injustice on the commercial community. The difficulty may be explained in a few words by a reference to the elementary conditions of our currency and banking system.

The government first provides the country with coin and currency, which by law is a legal tender for the payment of debts. The government thus creates the money for the people to use. The government then enacts a general banking law, and allows the banks to receive money on deposit and lend 75 or 85 per cent. of it, retaining only 25 or 15 per cent. of legal tender money as a reserve.

The government has thus enacted two contradictory laws. This was not done to favor the banks or because the banks controlled legislation, but because legislators did not see any other way of constructing the banking system.

First, our fundamental law, the Constitution, has made only gold and silver, or government money, a legal tender; and then, second, Congress has put it out of the power either of the banks or the people to live up to that law by legalizing the credit system of banking and of doing business.

The law making government coin and paper the only legal tender bears harder on the debtor class of the people than it does on the banks, who are mere automatic agents for receiving and paying money. The banks by lending their deposits — and they always endeavor to lend as near the legal limit as possible — create the debtor class, and they encourage the business world to use their money and go in debt by offering it at low rates. The law making coin and government notes the only legal tender for the payment of debts is kept in the background at such times by the ease in money. It seems to the borrower that there is a limitless supply of money on good credit or collateral. The point is overlooked by many that the thousands of millions of money held by the banks are all subject to the contradictory law which requires a lawful money reserve of 15 or 25 per cent., and if the reserve falls below those percentages then the thousands of millions of dollars are instantly locked up, and not a dollar can be legally lent until the reserve rises again above the legal requirement. Like the sailor on his raft, a debtor may well say, Money, money everywhere and not a dollar to be had, except at unusual or oppressive rates of interest.

Under our system of contradictory laws, the one a credit law in favor of the banks and the other a cash law to govern the people, when the reserve falls below the legal requirement by reason of activity in business or from any other cause, there

must be a scramble for money. Banks must stop discounting, debtors must liquidate, the price of money must go up, and the prices of commodities — other things being equal — must go down. The law properly forbids the banks to lend when reserves are impaired, and the only way to restore an easy condition is to liquidate enough business to provide the banks with the reserve of legal tender money which the law requires them to hold. This is tantamount to laying a tax on all business, in the shape of increased interest charges, and of paying that tax to foreign and domestic bankers, and of thus restricting legitimate business and making it more difficult for our manufacturers to compete in the markets of the world, and thus putting a clog on the wheels of prosperity.

It is very evident that our money laws should not be conflicting but harmonious, and should not restrict and depress industries but foster them, and should not be in favor of one class but of the whole people. How to harmonize or adjust them in a way absolutely safe to all interests is the question. It should always be safe to do that which is authorized by law. Now it is not safe for a merchant to enter into a legitimate business operation depending upon a continuance of the money market in a stable condition. The reserve is too easily encroached upon, and the money market is too easily upset.

The adjustment required by fair dealing with the people is to provide a credit currency acces-

sible to all the people through the banks by means of ordinary discounts, which the banks will be compelled to accept in payment of all debts to them. Then it is apparent the government will have done justice between the banks, which are conducted on the credit system, and the people, who are required to conduct their business on a cash basis. There will not then be one law for the banks and another law for the people. The argument is that if the banks are to be allowed to conduct business on the credit system a way should be provided by which the people also shall have the benefit of the same system.

But as it is the function of banks only to use money and not to create it, if a credit currency of universal acceptability is to be created to be used by the people in paying their debts to the banks, then the government must provide for such a currency through corporations specially authorized to issue it.

The contention of many of our best authorities on finance is that our clearing houses are the proper bodies, when incorporated under a federal law, to perform this service.

When once Congress has provided for a credit currency to be used in payment of debts to banks, which may be issued in case of emergency, then the pressure would be taken off the people, then the clog would be removed from active business, then justice would be done to the commercial world, which has suffered so long and so much under our present "evil and misguided system."

If during the past two months of August and September, 1899, the clearing houses of New Orleans, Chicago, St. Louis, St. Paul, Minneapolis, Milwaukee, Detroit, and other large financial centres from which the demand for currency has come had been able to issue a clearing-house currency secured by banking assets for fall use in moving our abundant harvests, the present flurry in money and consequent disturbance in business throughout the country would have been avoided.

Until our banking laws have been made to benefit and protect equally the banks and the business community, the prejudice against banks will exist and the agitation by misguided inflationists for more issues of money by the government will continue.

This is the only aspect of the banking question in which the people are interested. It is a measure which any politician can advocate on the stump before his constituents, whether they are traders or farmers, and to which any newspaper seeking to uphold and protect the interests of the people can freely give its support.

This is a non-partisan question, and sound-money Democrats can unite with sound-money Republicans in an effort to place our banking system on a stable basis by means of a safe and yet elastic credit currency.

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THE NATION says of the purpose of this book, that it is a "proposal to improve our banking system by legalizing and regulating the functions that have been assumed by clearing-houses in times of financial alarm," . . . "that there should be a clearing-house incorporated in every State by a national law, which should issue currency to banks on pledge of their assets as collateral."

JOSEPH FRENCH JOHNSON, Professor of Finance and Economy in the University of Pennsylvania, writes of Mr. Gilman's book in the *Annals of the American Academy* for September, 1898.

From Professor Johnson's Review.

The author of "A Graded Banking System" is a New York banker, who is alive to the defects of the present national banking system. His book is an effort to show how a bank-note may be provided which shall be safe and as acceptable as the present national bank-note, and which shall at the same time be issued promptly and in sufficient volume whenever the needs of trade require.

The first six chapters of Mr. Gilman's book contain general observations upon the theory and practice of banking, and a comparison of the United States system with the English, French, and German systems. The author then considers several remedies which have been proposed for the improvement of the United States system. The proposal to retire the greenbacks he considers unwise and useless. He accepts the Republican doctrine that the greenback can do no harm so long as a protective tariff is relied upon to furnish adequate revenue.

Mr. Gilman has a pretty clear idea of the service which a bank-note performs, and his book, so far as it relates to this subject, is valuable. He advocates the incorporation of State clearing houses, each clearing house to have the power to issue demand notes, and to loan them to any bank within the State, the borrowing bank to deposit current assets as security. The circulating notes issued to a bank shall not exceed 75 per cent. of the estimated value of the assets deposited. These notes shall be of any denomination desired, of one dollar or one thousand dollars, and shall be receivable at par at all the national banks in the country.

Mr. Gilman is an energetic worker for his plan. He has put it into the form of a bill, and appeared before the House Committee on Banking and Currency in advocacy of it.¹ In this bill a clearing-house association is authorized in any city of not less than six thousand inhabitants; but the privilege of issuing circulating notes is restricted to clearing houses which effect clearings of over two hundred millions of dollars annually, or to the chief commercial city in each State; and if there are in any State two or more clearing houses having the right of issue, then the Comptroller of the Currency shall divide the State into clearing house districts, and banks in each State or district shall do business only with the clearing house of issue in their State or district. The circulating notes shall be redeemed on demand by the clearing house of issue, and also by the bank through which they were first paid out. The notes are to be furnished by the national government, and the Comptroller of the Currency is to exercise supervision over the affairs of all clearing houses as well as of banks.

Mr. Gilman's plan deserves attention. In some respects it is far superior to the plan advocated by the Monetary Commission, or to the plan reported by the House Committee. Both these measures provide for the independent issue of circulating notes by some four thousand isolated banks under conditions which will furnish strong inducements to each bank to keep afloat the largest possible quantity of its notes. They make those notes receivable at par by all banks and by the government, aiming thus to secure for them the widest possible circulation. Mr. Gilman would secure wide currency for his notes by compelling their acceptance by banks, but he restricts the right of issue to forty or fifty institutions, and this is a very important matter. It is easy enough to devise a scheme which shall result in the abundant issue of bank-notes, but it is quite another matter to provide

¹ Bill H. R. 9279, 55th Congress, 2d session.

that the issue shall be restricted whenever the occasion demands. Undue expansion of the currency volume is an evil which framers of bank-note systems must always have in mind, for bank-notes may drive gold from the country, and so embarrass the United States Treasury quite as effectively as greenbacks, silver dollars, or Sherman notes. Under Mr. Gilman's plan, the issue of notes would be in the hands of comparatively few men, and it is fair to assume that they would be financiers capable of understanding the far-reaching influences of all their operations. At a time when gold was being withdrawn from the United States Treasury for export, it would be reasonable to expect that these men would perceive the necessity for a restriction of bank-note issues, and would refuse applications of banks for further loans. In this respect, therefore, Mr. Gilman's plan is decidedly better than any plan which leaves the issue of bank-notes entirely at the discretion of several thousand men scattered all over the country.

Mr. Gilman's plan must be regarded as encouraging evidence that practical men of affairs are beginning to understand not only the necessity for a revision of the banking laws, but the nature of the problem which is to be solved. If his plan were adopted, the country would undoubtedly have a much better bank-note than it has at present, and it is quite probable that minor defects would be perceived and corrected before any mischief had been done. Mr. Gilman is certainly right in his belief that the circulating notes provided by such a system would tend to render impossible such panics as the business of the country passed through in 1873 and 1893. As a protection against panics due to a dearth of media of exchange, his system would undoubtedly prove effective.

THE BANKERS' MAGAZINE, NEW YORK, says:

"Federal clearing houses, acting under a uniform national law, with membership open to all National and State banks, are suggested in a communication from Mr. Theodore Gilman, published elsewhere in this number, together with a bill designed to provide for such organizations. Its underlying principle is to bind all the banks together into a coöperative system, and to permit the issue of notes by the banks on the security of assets deposited with a central clearing-house association, of which there shall be at least one in each State. The responsibility for the redemption of the notes is to be assumed by all the banks of a particular State or district; and in case an assessment on these banks shall not provide sufficient funds to redeem the notes of failed banks, an assessment is to be levied on all the banks in the country that are members of the clearing house association. There is no doubt that, if all the banks could be brought together in some way that would not be open to the charge of monopoly, it would be a happy solution of one of the most vexing questions in American banking; namely, to give to the banks of the United States the stability of great central banking institutions of large capital, and at the same time preserve the

autonomy which is such a prominent characteristic of our banking system. Mr. Gilman's proposals seem well calculated to lead to this result, so far as it can practically be done.

"Circulation based on commercial assets could be made secure by a safety fund contributed by all the banks of the country, but there would be an element of injustice in the operations of such a plan. Under it the banks of a conservative State where failures are almost unknown would be continuously taxed to provide for the redemption of the notes of failed banks in some other State where bank management is comparatively reckless. It is objectionable in this respect in much the same way as a tax on all the banks to insure deposits. As to its expediency, however, that is another matter.

"But under Mr. Gilman's plan, the banks of a certain district or State are given some control over the issue of notes in their jurisdiction, and the penalty for any abuse of that authority is made to fall first upon them. This is, of course, a modified application of the safety-fund principle, and one that seems entirely proper. It appears preferable to a general fund contributed by all the banks, and made available for the redemption of notes of all failed banks. As nearly as may be, it seeks to impose the penalty for violation of sound banking rules upon those most immediately concerned in the offense.

"The propriety of allowing all banks in the United States to issue notes on the security of their general assets, even with the additional safeguard of a fund contributed by all the banks for the redemption of the notes of failed institutions, is open to serious question. To confine the privilege to the banks of large capital would give just grounds for the cry of monopoly which would surely be raised.

"In the panic of 1893, hundreds of really solvent and well-managed banks were compelled to suspend temporarily, and it is not improbable that most of these failures, with their attendant consequences of ruin and disaster to business interests, might have been prevented. It is the opinion of so well-informed a banker as Mr. Charles Parsons, of St. Louis, that the issue of one hundred millions of such currency as permitted by the measure under review, would have saved half or two thirds of the ill-effects of that panic.

"The banks of the United States linked together are practically invincible, and to effect such a result without creating a monopoly would not seem to be impossible, as the principle has long been in successful operation on a limited scale in the large cities of the country.

"When Congress shall take up the currency question with a disposition to deal seriously with the subject, the proposals of Mr. Gilman will be found worthy of careful consideration."

THE NEW YORK TRIBUNE says: "Mr. Theodore Gilman writes on 'an elastic currency' in a manner which is most

refreshing, after the deluge of assumptions that desired elasticity of currency can be obtained only by unlimited issues of bank-notes. It will be observed that he offers not one word in favor of intrusting to every bank the power to make currency on the basis of anything it may consider good assets. Plainly, Mr. Gilman knows that such a plan would be inadmissible, and the virtue of his proposal is that it would provide a powerful safeguard respecting emergency issues of currency.

"It should be said that Mr. Gilman's plan has in it merits incomparably beyond those of other schemes which have received great attention. It does provide some safeguard against the excessive issues of notes by any one bank upon what it may please to consider good assets. It puts the faith and business experience and personal interest of a number of banks behind any issue permitted, and enlists them to insure its retirement. That this proposal can be so modified as to be of vast service to the country will not seem improbable to those who have read Mr. Gilman's book on the subject, or his statement last year before the Banking and Currency Committee."

"The committee appointed to recommend a currency measure begins its work this week, and it embraces some of the ablest and most influential Republican members of Congress. It was created by a caucus at the last session, in the hope that it might devise a measure which would command the support of Republicans in the next House.

"Whatever opinion members have held, they will doubtless feel that the trust confided to them imposes the duty of candid and careful revision and comparison of opinions, in order to meet, not their individual preferences, but the wishes of the whole body of Republican members.

"In this light, the committee will not fail to consider that every proposal to retire the greenback currency in order to make room for more bank circulation has met and is certain to meet strong Republican opposition. It may be granted that sound reasons exist for meeting any demand for larger paper circulation, or a circulation more readily adjusted to the changing needs of business, by some enlargement of the bank issues, and provisions to that end do not involve any interference with the existing legal-tender circulation. Of all plans for adjustment of the bank circulation to the needs of business, the one which seems to furnish a better basis for wise and safe action than any other yet offered is that urged by Theodore Gilman, of this city, before the Banking and Currency Committee, April 13, 1898, and approved by Charles Parsons, of St. Louis, formerly president of the American Bankers' Association."

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